

The Aldrich Plan
in the Light of
Modern Banking

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THE ALDRICH PLAN IN THE
LIGHT OF MODERN BANKING

The Aldrich Plan in the Light of Modern Banking

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Robert R. Johnston
New York
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Contents

Preface.....	ix
Introduction.....	xi
Chapter I	
The American Banking System, Central Banking, and the Aldrich Plan.....	1-57
A. The American Banking System.....	3-27
I. The Existing System.....	3
Table 1. Capital and Out- standing Notes of National Banks.....	5
II. Defects of Our Banking Sys- tem, Causes and Effects	9
Table 2. Reserves in Na- tional Banks.....	6
III. Crisis of 1907.....	22
Table 3. Emergency Cur- rency Issued During the Panic, 1907	25
B. The Main Features of Continental Banking.....	28-49
I. Centralization and Elasticity of Note Issue.....	28
II. The Money Market and the Note Circulation.....	31
III. The Policies of Central Note Banks.....	36
IV. Publicity.....	41
Table 4. Important Items, Statements of the German Reichsbank.....	43
Table 5. Important Items, Statements of the Bank of France	49

Table 6. Outstanding Notes of the National Banks....	49
---	----

C. Fundamental Ideas of the Aldrich Plan 50-57

Chapter II

Details of the Aldrich Plan..... 59-109

I. Charter and Membership	61
II. Organization of the Association.....	67
III. Functions of the National Reserve Association.....	77
1. Reorganization of the Bank Note System.....	78
2. Protection of the Gold Reserve	89
3. Deposits and Domestic Exchange.....	91
4. Discount Activities at Home.....	92
5. The Ownership of Real Estate.....	97
IV. Duties of the National Reserve Association.....	98
V. Activities of Banks Belonging to the Association...	99
VI. Obligations of Membership in the Association	104
VII. American Banks in Foreign Countries.....	106

Chapter III

Criticism 111-176

A. The Plan and the Principles of Banking 113-151

I. Capital Stock and Reorganization of the Note Issue	115
II. The Association in Relation to the Constituent Banks	120

Table 7. Classification of Bills Discounted by the German Reichsbank.....	126
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CONTENTS

vii

III.	The National Banks under the New Conditions.....	137
IV.	Suggested Modifications for the Aldrich Plan.....	146
B.	The Opposition to the Aldrich Plan	152-169
C.	Conclusion	170-176
Appendix	.....	177-217
A.	The Bill Introduced by the National Monetary Commission.....	179-194
	Index of the Bill.....	179
B.	Suggested Plan, Revised Edition (Al- drich Plan).....	195-203
C.	Suggested Plan, Original Edition (Al- drich Plan).....	204-210
D.	Tables.....	211-217
I.	Distribution of Gold Coin and Bullion in the United States	211
II.	Debt of the United States, and Bonds on Deposit	211
III.	World's Production of Gold, 1910	212
IV.	Banking Power of the United States	213
V.	Condensed Statement of all Reporting Banks of the United States.....	214
VI.	Reserve of the National Banks	215
VII.	Classification of National Banks	216
VIII.	Gold in the Treasury and in the Banks of the United States	216
IX.	Gold and Silver in the Euro- pean Central Banks.....	217
Index	.....	219-227

Preface

This work has grown out of a publication which appeared in German early this year under the title *The Aldrich Plan, its Significance for American Banking and the International Money Market*. The purpose was to present to German readers an account of the proposed reforms in American currency and banking, to analyze the Aldrich plan as embodying the labors of the Monetary Commission, and to indicate the strength and weakness of its various features, and its probable significance for American banking.

The appreciation shown by American readers of the German work has encouraged the author to prepare a second edition in English. The original book has been enlarged. For a better understanding of the problems of banking reform, and the measures advocated, an account of European central banking has been added, and its essential features are contrasted with the existing American system, and with the provisions of the Aldrich plan.

The fundamental idea of the original book has been retained in the work here offered. It aims to present an impartial discussion of the merits and shortcomings of the Aldrich plan from the point of view of banking theory and practice. It is hoped that an objective discussion of the problem before the country will contribute to the cause of reform in our currency and banking.

Acknowledgment is due to Mr. Heinrich T. Reccius, formerly my assistant at the Berlin University of Commerce, for valuable help in the preparation of this book, and to Dr. H. G. Friedman, who is responsible for the English of the text.

July, 1912.

LUDWIG BENDIX.

Introduction

Since the panic of 1907 there has been no difference of opinion as to the necessity of reform in our currency and banking. There is disagreement only as regards ways and means of effecting betterment. It is held, on one hand, that the present structure must be preserved, and that reform must leave its essential features untouched. It is contended, on the other hand, that our present monetary and banking system is antiquated and inadequate, and that the recurrence of disastrous panics can be averted only by a thorough reorganization of the currency and credit system on a modern basis.

The conservative element believes that the existing system is essentially sound, and in the main, adapted to American needs. Radical departure from it involves grave dangers, political and financial, which are likely to be more serious than the present evils. Any plan of reform should, therefore, preserve the autonomy of banks, and maintain decentralization in banking. Conceding the necessity of modifications that will make the currency more elastic and provide for mutual aid in critical moments, defenders of the present system seek to attain this object by making provision for an emergency currency. This is to be issued in times of stress on the plan of the clearing-house certificates, by local organizations of banks along the lines of the currency associations authorized under the Vreeland-Aldrich Act. In the opinion of the conservative element a central bank should be avoided at all costs.

The more radical critics believe that the existing system is

essentially defective. The inelasticity of the currency can not be remedied so long as Government bonds are used as the basis for the issue of banknotes. The dispersion of our reserves of gold and lawful money is a constant menace to the banks, as it leaves them without protection in "runs" and panics. In the absence of a national money market for short-time loans and discounts, the surplus funds of the country can not be distributed so as to meet the credit needs of different sections equitably.

The remedy for the situation, according to the radical program, is in a central bank along European lines. This institution should be entrusted with the reserves of the banks and the funds of the government. It should have the sole right to issue notes. In order that currency may expand and contract in keeping with the demands of business, commercial paper must be substituted for bonds now used as the basis of note circulation. The use of bank acceptances and commercial paper as instruments of credit should be encouraged, and a money market for short-time loans and discounts, subject to the supervision and control of the central bank, should be built up. With credit and currency reorganized along such lines, the country would be safeguarded against panics, and the worst evils of a crisis obviated.

The Aldrich plan is necessarily an attempt at compromise. It endeavors to maintain the characteristic developments of the American system, namely, decentralized banking. On the other hand, it seeks to give the United States the benefits which European countries derive from central banking. It would achieve this purpose, not through a central bank, but through the coöperative activity of the existing institutions, and by means of an agency organized by them and largely under their control.

The adoption of a new banking policy involves compro-

mise everywhere. Changes must be in harmony with prevailing political and economic conditions. A practical banking policy can not adopt an ideal system as its goal, but must content itself with what may be immediately realized. Of no country is this more true than of the United States. With states jealous of the growing strength of the Federal Government, a banking institution under national charter, endowed with large powers, will doubtless call forth opposition on the ground that it tends to increase the Federal authority. Moreover, central banking in the United States recalls unpleasant memories of political interference in the affairs of banks. Proposals for the centralization of the note issue are viewed with suspicion. There is a fear that the sinister influences of financial interests and of the stock exchange may be lurking behind the movement. Furthermore, national banks are inclined to be alarmed at any step that may involve encroachment on their rights or competition in their sphere of business activity.

Under the circumstances the creation of a central bank, with exclusive control of the note issue, must be considered inexpedient. That such institutions, existing, in some instances, more than a century, have succeeded in Europe, does not argue that they would be equally fortunate in this country. As A. Piatt Andrew,* formerly Assistant Secretary of the Treasury, well observes: “. . . It would be visionary indeed to suppose that we could raze the construction and growth of more than a century, and rebuild upon another plan. We must accept our traditions and build upon them.”

In the discussion of the Aldrich plan here offered, no particular point of view and no special cause is championed.

*A. Piatt Andrew, formerly Assistant Secretary of the Treasury, “The Essentially American Sources of the Proposed Banking Legislation.” Address delivered before the Indiana Bankers’ Association at Indianapolis, October 24, 1911.

Criticism must take account of existing conditions. It can not be expected that the legislation proposed will meet the ideal requirements of a banking system. The real test is whether, in spite of the obstacles in the way of reform, it gives promise of substantial improvement in the American system of currency and credit. It is the purpose of the following pages to consider in detail to what extent the plan meets the needs of the country.

CHAPTER I

The American Banking System, Central Banking, and
the Aldrich Plan

A. The American Banking System

Banking serves as a general intermediary in the business life of a country. The importance of banks can not be overestimated. In no small measure, the industrial weal and woe of a nation depends on the character of its financial institutions, their adequacy and success in fulfilling their function in the economic process. For these reasons, greater importance probably attaches to the proposed reforms of the monetary and banking system of the United States than to any other measure of recent years in the field of economic legislation.

I. The Existing System

Essential in a banking system are banks for the issue of circulating notes. The general banking organization is almost wholly dependent on the character of these institutions. The note banks are most intimately related to the money market and to credit transactions in general. In consequence, they exert a decisive influence on the entire business activity of the country, and are, so to speak, at the heart of its industrial life. In the United States the method of issuing notes has long been the most vulnerable part in the banking system, and the object of reiterated and just criticism. The proposed reforms, therefore, properly address themselves in a large measure to remedying this defect.

The note banks in the United States are the national banks, and, except for the recently created postal savings-

banks, these are the only financial institutions under federal authority. The law under which the present system was built up dates back to 1863, and in spite of various amendments and modifications, its essential features have remained unchanged. A prohibitive tax was at that time imposed on notes emitted by state banks, and these banks of issue, then in existence under state charters, were obliged to incorporate as national banks, or abandon the issue of notes.

The characteristic features of the American system are: (1) the use of the bonds of the United States government as security for the bank notes issued, and (2) decentralization. Notes may be and are issued by many thousand national banks. No provision is made for a central bank, and national banks with the right to issue notes may be established anywhere, so long as the regulations of the law are complied with. The most important requirements of the bank act in this regard are: (1) possession of a minimum capital, graduated according to the size of the city or town in which the bank is located, and (2) the deposit with the Secretary of the Treasury of United States bonds equal in amount to a certain percentage of the bank's capital stock (one-fourth for smaller banks and one-third for larger institutions), such deposit not to be less than \$30,000 in any event. On complying with these provisions, a corporation composed of not less than six persons is authorized to issue bank notes. As a result we have today more than 7,300 national banks, scattered all over the country, all of which are thus empowered.

The most influential banks, from the point of view of their capital and volume of notes in circulation, are found massed in the East and in the Middle West. Within narrower limits, the leading banks are located in a few large cities. Characteristic of the concentration of banking resources is the fact that New York and Eastern reserve cities alone account for \$98,500,000 of the total amount of \$214,-

300,000 notes issued in the Eastern states. The following table gives a view of the situation:

TABLE 1—CAPITAL AND OUTSTANDING NOTES OF NATIONAL BANKS, APRIL 18, 1912*
(in millions of dollars)

TERRITORY	Number of Banks	Capital Stock and Surplus	Outstanding Notes		
			All Reserve Cities	Other Cities	Total
New England States.	465	\$162.8	\$ 8.4	\$ 54.0	\$ 62.4
Eastern States	1641	671.6	98.4	115.9	214.3
Southern States	1477	248.5	20.3	107.9	128.2
Middle Western States	2042	418.5	70.7	119.9	190.6
Western States	1247	101.4	10.1	42.0	52.1
Pacific States	479	121.4	33.6	25.5	59.1
Island Possessions ...	4	0.9	....	0.3	0.3
Total	7355	\$1725.1	\$241.5	\$465.5	\$707.0

The issue of bank notes is subject to peculiar regulations: In the first place, an absolute limit is imposed on the amount that can be put into circulation. No bank may issue an amount of notes greater than the amount of its capital stock. In the second place, only the bonds of the United States may be used to secure notes. In order to issue notes, a bank must first deposit bonds with the Secretary of the Treasury. In return, it receives notes equal in amount to the face value of the bonds, if two per cent bonds are deposited, but only 75 per cent, where three per cent bonds are offered as security. The bank must furthermore maintain with the Secretary of the Treasury a redemption fund which must not fall below five per cent of the outstanding notes. By this provision there is created a central agency for the redemption of the notes of all banks. The maintenance of this redemption fund does not, however, absolve any bank from the obligation of redeeming its notes when presented at its place of

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*Latest figures available for this classification.

business. Every bank must, moreover, accept the notes of every other bank. In case of voluntary or compulsory liquidation, the bonds of the bank on deposit are sold by the Secretary of the Treasury, and the funds realized are used for the redemption of its outstanding notes.

The method of retiring notes from circulation is as follows: The bank must deposit with the Secretary of the Treasury in cash the amount of the notes to be withdrawn. The bonds by which they were secured are thereupon returned to the bank, and the Treasury Department assumes responsibility for the notes. There is, however, an important restriction: no more than \$9,000,000 may be retired in any month by all of the banks taken together. The regulations here outlined for issuing and retiring notes serve very fully to safeguard the holder of the notes, but the procedure is extraordinarily cumbersome and complex.

The profit of a bank on the issue of notes is derived from the income on the bonds and from the interest paid by the borrower for the loan which he receives in the form of bank notes. From this gross profit there must be deducted, besides the expense connected with the circulation, a tax of one-half of one per cent on the amount of notes outstanding. Deductions must also be made for the probable return on the capital if it were invested in some other security of similar character. The net income on the bonds is, of course, dependent on their purchase price. Therefore, whether or not it is profitable to issue bank notes is determined *primarily* by the price for bonds. Taken as a whole, the circulation privilege is not very valuable to the banks. For this reason they have not used it to the limit. On June 14, 1912, the banks had \$708,700,000 of notes outstanding, although their capital authorized them to issue \$1,033,600,000, or nearly fifty per cent more than the amount in circulation.

The banks have developed their deposit business far more

extensively than their note circulation. Thus, on June 14, 1912, deposits were over eight times as great as the note issue: \$5,825,500,000 as against \$708,700,000. Changes in the amount of deposits mean more to the banks than fluctuations in the volume of their outstanding notes. It may be properly said that the national banks are first of all banks of deposit, and that the issue of notes is of secondary importance to them.

Like the note issue, the deposit business of the national banks is subject to certain restrictions. Of most consequence is the requirement that the banks keep on hand, at all times, a reserve in lawful money equal to a fixed percentage of their deposits. Should the reserve fall below the prescribed minimum, the Comptroller of the Currency is authorized to close an institution unless its reserve shall have been made good within thirty days from the date of his notice. The percentage of the reserve to be kept varies according to the size of the place in which the bank operates. The law assumes that in smaller towns business is less subject to wide fluctuations, and accordingly, banks so located may keep smaller reserves than those in larger cities. Three classes are recognized by law: country banks, banks in reserve cities, and banks in central reserve cities. Country banks are required to keep reserves of 15 per cent, other national banks must hold reserves of 25 per cent. This differentiation becomes more marked when we consider what reserves must be kept by the banks in their vaults. Thus country banks may keep as much as three-fifths of their reserves on deposit with national banks in reserve or central reserve cities. Such banks are designated as reserve agents. Reserve banks, again, may deposit one-half of their legal reserve with banks in central reserve cities. The latter are New York, Chicago, and St. Louis. The effect of these provisions is to reduce the actual cash reserve very

decidedly. Reserve agents are not obliged to keep the deposits representing the reserves of banks in lawful money. Such deposits are treated by them exactly as other deposits.

For the enforcement of the law the Comptroller of the Currency has been given far-reaching authority over the banks. They must submit statements at specified intervals, and they are subject to examination by his agents, whenever he deems it necessary. He is authorized, as we have seen, to close a bank, if, after thirty days' notice, it fails to bring its depleted reserves up to the legal requirement.

The regulations noted, and others too numerous to mention here, serve to limit the freedom of action of the national banks in receiving deposits and in making loans. As a result, the last few decades have been marked by a far more rapid growth of banking institutions, organized under state laws, than of national banks. The state institutions are exclusively banks of deposit, of which the most prominent are the so-called state banks and trust companies. Like the national banks they are also subject to certain requirements in the matter of reserves, but in general, they enjoy more freedom. The trust companies are interfered with least. This is evident from the character of their assets. They invest largely in mortgages, and also participate in speculative flotations of securities. On the other hand, some of them do not accept demand deposits to any considerable extent.

In contrast with the trust companies, state banks, like national banks, take practically no part in the floating of securities and generally do not to any appreciable extent lend on real estate mortgages. Their chief business is to make short time loans on securities of all kinds, and to discount notes and bills. Besides loans and discounts a

large amount of securities is reported among their assets.

Taken together the 24,358 banks of the United States reporting to the Comptroller on June 7th, 1911,* had a capital and surplus of \$4,008,000,000 and deposits amounting to \$18,529,000,000. Practically three-fifths of their resources (\$13,015,000,000) were represented by loans, discounts, and checks; more than one-fifth (\$5,043,000,000) was invested in bonds and other securities. In financial resources the state banks and trust companies have outstripped the national banks. On June 7th, 1911, their capital and surplus was \$150,000,000 greater than the capital and surplus of the national banks, the figures being \$2,085,000,000 and \$1,933,000,000 respectively. Similarly the deposits of state institutions, amounting to \$10,428,000,000, were almost double those of the national banks (\$5,526,000,000).

Notable, in a survey of the financial organization of this country, is the geographical distribution of banking resources. This is even more marked in the case of state banks and trust companies than in the instance of the national banks already mentioned. Two-fifths of the combined resources of national and state institutions are held by the banks in the Eastern states, over \$10,000,000,000 in all. Next in importance are the financial institutions of the Middle West, with resources of \$5,758,000,000, or over one-fourth of the total for the country. (See Appendix, Tables IV and V.)

II. *Defects of Our Banking System— Causes and Effects*

The existing banking organization has time and again proved inadequate. There are two principal causes. In

*Latest figures available for comparison, *Annual Report of the Comptroller of the Currency, 1911.*

the first place, an antiquated and inefficient reserve system. The national reserve of gold and lawful money is widely distributed, and the usefulness of the reserves held by the individual banks is seriously diminished by the institution of reserve cities combined with rigid requirements in regard to the amount of cash that must be kept on hand. In consequence the bank reserves of the country are incapable of centralization and mobilization. In the second place, our bank note circulation rests on the security of government bonds, and is, on that account, inelastic and unresponsive to business needs. The truth of these criticisms is generally admitted.

The main object in permitting banks to issue circulating notes, and the fundamental justification for the existence of such institutions lies in the need for a supplemental currency, to be used under certain conditions, along with the other forms of money, or, in part, as substitute for money. The necessity for a supplemental currency arises from the fact that the volume of business transactions is not constant, but fluctuates, with the result that varying amounts of currency are required to carry on business at different periods. A certain minimum is needed at all times. When, however, trade is active, and the volume of transactions rises, the demand for currency likewise increases. Certain large demands for currency occur (1) In the course of each year; (2) In the course of every business cycle; (3) In crises when there is an especially urgent demand for money.

(1) In any given year money stringencies occur at the settlement periods and more particularly in autumn, when the moving of the crops usually has the effect of stimulating business.

(2) At the close of a period of business depression, when conditions have definitely changed for the

better, increased business activity creates a demand for more currency, and the demand gradually grows in accordance with the progress of the boom.

(3) The greatest demand for currency comes in the course of a business cycle after the boom has reached its highest point, when trade begins to decline, as a period of depression comes on. As soon as the tide turns, sales drop off sharply, and new trade is difficult to secure. Collections become slow. In addition, most business establishments find themselves involved in obligations entered upon in the belief that prosperity would continue. To fulfil their obligations they must obtain funds on credit. An active demand for money accordingly sets in at the banks, and it is more general and urgent, if the business depression is acute and assumes the character of a crisis or of a panic.*

It is in times of money stringency that the bank notes of the country are called upon to serve as a supplementary currency. For this function the bank note circulation must be very closely interrelated with the business of the community. Otherwise it can not adapt itself to the varying needs arising in the course of the year, to the larger requirements made upon it as a business cycle progresses, or to the urgent demands of a crisis.

Two qualifications are fundamental for a bank note system. It must be able to expand and to contract in keeping with the changing needs of business. The bank currency must be sufficiently elastic to meet the wants of trade. It is equally important that it should be retired from circulation as soon as it has served its purpose. Unless the system admits of contraction, notes will remain in circulation after the need for them has passed away. These notes

*For fuller discussion see pp. 30 and 31; 38 and 39.

do not represent real money, but are merely credit instruments. Kept in circulation, they serve to give the false impression that there is a superabundance of money or capital in the market, when in fact there is only an inflation of bank notes. They can not take the place of the real money or actual capital which is required for a healthy forward movement in business. The result of their use is usually unsound expansion inevitably terminating in a collapse.

The note circulation of the national banks does not meet either of the two above requirements. It is based on the government debt, and therefore can not possibly possess the elasticity required of a bank note system. It does not admit of the rapid expansion needed for meeting a money stringency. Even if the improbable supposition is made that the supply of government bonds needed to enable them to issue additional currency is kept on hand by the banks, the process of emitting notes is so exceedingly complex that it takes about two months to put new notes into circulation. Contraction of the currency is also extremely difficult. After the need has passed away, notes can be retired only in an equally roundabout and impractical way. Aside from the long delay involved, the law interposes a further obstacle in prohibiting the retirement of more than \$9,000,000 notes in any one month. This legal limit is far too low: under it not enough notes can be retired to produce any immediate beneficial effect.

These are grave defects in the existing note system. Even more serious and more harmful is the absence of any relation between the increase and decrease of the circulation and business requirements. The fluctuations in the circulation depend primarily on an entirely different factor—the amount of profit realized by the banks on the note issue. Notes are withdrawn when banks find it financially more ad-

vantageous to retire them than to allow them to remain in circulation. The profitableness of the circulation, as shown above, is determined, in the main, by the prevailing price for government bonds. This price again is largely dependent on the volume of bonds outstanding and on the demand for such security. Thus the price of government bonds is made the decisive factor in the expansion or contraction of the note circulation. The bank note currency, whose influence is of the utmost importance to commerce and industry depends on factors unrelated to the general course of business—the amount of government bonds in existence and their prevailing market price. That resulting conditions are often intolerable is not surprising. The bank note system had its origin in urgent fiscal needs of the government during the Civil War. It was constructed neither in conformity with sound financial theory, nor to meet the requirements of banking. “It came into existence,” as Mr. Andrew* says, “as a means for floating government bonds during the Civil War . . . and it has proved wooden and unresponsive, increasing and decreasing in amount according to the prices of government bonds or their quantity outstanding, and never in response to the changing demands of business.”

The present system is unable to cope with the usual seasonal demands for additional currency; it is a complete failure when confronted with an acute money stringency, such as comes with the beginning of a business depression. Owing to the impossibility of expanding the currency to meet just such emergencies, untold harm is done. Instead of a gradual transition from a boom to a period of depression, the change is made abruptly, resulting in a crisis, which brings ruin and often becomes a widespread panic.

* “The Essentially American Sources . . . etc.,” cited in Introduction.

The danger of financial and industrial upheavals at just such times is intensified by the banks—the very institutions whose duty it is to save the situation and prevent a panic. This results from the dispersion of the cash reserves among the scattered banks, the system of reserve cities, and the requirement that the banks must, at all times, hold in cash a prescribed percentage of their deposits. Under this system every bank knows that in an emergency, it must rely upon its own resources. There is no powerful agency to which it can look for help in its extremity, and its claims on reserve cities represent actual cash reserve only in a small degree. Should anything untoward happen, and give ground for doubting the ability of some banks in one section or another to meet their obligations, the banks are the first to become anxious. They begin to take precautions in advance of any demand for cash from depositors. Thinking only of themselves and how they can best prepare for a possible run, they make every effort to hold the cash which they have on hand. Moreover, they seek to increase their stock of money as much as possible. This additional cash they obtain, in part, by withdrawing it directly from use in business, through calling in loans or refusing to renew accommodations. Finally they endeavor to secure money by withdrawing their deposits with agents in reserve and central reserve cities.

Under pressure from country banks, the system of reserve agents is bound to collapse. It is workable only when the demand made upon reserve agents by banks from one section of the country can be met with funds supplied by institutions from another section, where money happens to be plentiful. So long as confidence prevails, it usually works out in this way. The moment, however, confidence fails, and a simultaneous demand is made by banks from many sections of the country, reserve agents, or banks in the reserve

and central reserve cities, inevitably find it impossible to meet their obligations. In such a situation, the public soon comes to fear that the banks will not be able to maintain cash payments. A panic follows. The banks can not meet the run on them even for a short period. Widespread suspension of payment with its attendant disasters is inevitable. According to Mr. Forgan* the dispersion of the cash reserves of the country, which makes it impossible to concentrate and use them effectively, and the requirement that banks hold in reserve a fixed and unvarying percentage of their deposits in cash, regardless of conditions, constitute prime causes for the outbreak of panics.

The depositor's fear that he will be unable to obtain cash is not entirely ungrounded. It is obvious that with a general demand for money, the cash reserves of a bank can not hold out long. The usefulness of its stock of money for meeting demands is furthermore impaired by the rigid legal requirement as to reserves, which means, in effect, that the greatest part of the cash on hand can not be used for its primary purpose—that of meeting the demands of depositors. It might almost as well be nonexistent.

Banks do not keep on hand much more money than the law requires. The amount which they have available for payments to depositors, without encroaching upon the legally required reserve, is very small. This is particularly true of the banks which must bear the brunt of the demand for cash, namely, the reserve agents. The situation is made clearer by the following table in which are shown the actual reserves held by the banks and the legal reserve for June 14, and April 18, 1912. Under the reserves held by the banks are included their deposits with reserve agents.

*James B. Forgan, President of the First National Bank of Chicago, Ill. "The Mobilization and Control of the Reserves of the Country." Address delivered before the American Bankers' Association at New Orleans, November 21, 1911.

TABLE 2.—RESERVES IN NATIONAL BANKS, 1912

Classification	Percentage of Reserves		Minimum Legal Reserve Percent
	June 14	April 18	
Country banks	22.5	23.4	15
Reserve city banks	28.1	28.6	25
Central reserve city banks	26.2	25.9	25

The minimum reserve required by law is tied up, whether it be 15 or 25 per cent. It is evident, therefore, that the lawful money which can be used to meet depositors' demands is not plentiful. On June 14, seven and one-half per cent is shown for country banks and three per cent for reserve cities. Even these amounts are not actually available, for they include deposits with reserve agents, and the latter do not hold these funds in the form of separate cash. How significant such deposits are is evident when we consider that on April 18,* the banks in reserve cities had \$251,100,000 in their own vaults and carried \$288,700,000 with agents in central reserve cities. The country banks had cash to the amount of \$248,700,000, and held with agents in central reserve and reserve cities \$521,200,000. The banks in central reserve cities held in lawful money only one per cent more than the legal reserve. In spite of the fact that the deposits of institutions from smaller towns may be called in by them at any time, the banks in the reserve and central reserve cities, which carry so much of these deposits, find themselves with little cash above the legal minimum. (See Appendix, Table VI.)

With the concentration of deposits in about 50 reserve and central reserve cities, it is evident that the banks in these cities can not have enough cash to repay any considerable

*Figures for June 14 not yet published.

portion of their deposits. Needless to say, they are without resources for additional accommodations to their customers, which a crisis makes so urgently necessary. Their assets can not be liquidated and converted into ready money in times of stress. The most available of their investments, loans on stock market collateral, are at that moment practically unrealizable. The securities protecting the loans are either entirely unsalable, or they can be disposed of only at ruinous prices, for one of the earliest symptoms of an impending crisis is a collapse of prices on the stock exchanges. A very valuable part of the remaining assets of the banks, discounted notes and bills, are, in the main also unrealizable investments. There is no agency through which they might be rediscounted, for, even in normal times, there is no general market for commercial paper, and in fact there is no organized money market at all.

The lack of a money market in the United States, that is, a general market for short time loans and the discount of commercial paper, is felt most keenly in emergencies. Industrial activity is, however, unfavorably affected by the want of it at all times. Thus far, there are merely the beginnings of a money market, and that only in the largest cities. But one phase has been developed: call loans on stock market securities. The other and more essential phase, a market for commercial paper or discounts, scarcely exists. At any rate, it is of far less importance than the market for call money. In this respect the United States is far behind European countries, where the market for commercial paper is the backbone of the entire money market.

The reasons for the failure to develop a useful money market lie in the antiquated banking system. (1) For extensive transactions in discounts there are needed bills of a high character, bearing names which are known throughout the

country, and which make the paper universally desirable for investment. In European countries, this standardization of bills is accomplished through the banks. Bank acceptances constitute the predominant and safest form of commercial paper bought and sold in the open money market. In the United States, however, the leading banks are forbidden to accept bills. As a result few acceptances of a high grade are available as the basis for a regular business in short time loans and discounts. (2) Of greater influence, however, is the absence of a central banking institution. Without such an agency, there can be no extensive market for notes and bills. The market must have as its foundation an institution where good commercial paper can always be rediscounted and converted into currency. Banks, singly, are not in a position to fulfill this requirement, because they can not be relied upon to have the necessary funds on hand at all times.

In the absence of a central banking institution from which banks can always secure currency by rediscounting their good commercial paper, financial institutions do not find merchants' bills or even bank acceptances a desirable investment for their "surplus funds."* There is no way in which such paper, however excellent, can be converted into cash, in case of need. If a bank lends on such securities, it ties up its resources until the former mature, since there is practically no possibility of turning bills into ready money before they fall due. Under the circumstances, banks are not inclined to invest their surplus funds in discounts; on the contrary, they prefer to place as little of them as possible in commercial paper. In consequence it is more difficult for a merchant or manufacturer to negotiate a note or bill in

*The expression "surplus funds" is used to indicate funds which must be held in liquid form, to meet probable demands of depositors and of regular customers of the bank. [Cf. page 20.]

the United States than it is in Europe; and in spite of their marked advantages comparatively little use is made of them.*

Such conditions tend to interfere with the building up of a market for commercial paper or discounts. So far as it exists at all, it is limited in extent, and only of local importance. One result of this situation is that no small part of the existing commercial paper of the United States is sent abroad to be discounted in the money markets of Europe, and as only the bills of the best known American establishments can be negotiated abroad, European sources of credit are not open to the average American business man.

The absence of a market for commercial paper means further that in the field of foreign trade we are almost entirely dependent upon European banks. Bank acceptances are the usual currency employed in the export and import business. Before it is acceptable in payment, the note or draft drawn in settlement of the transactions must bear the endorsement or guaranty of a bank with an international reputation—to secure the certainty of prompt redemption at maturity and the possibility of immediate conversion into cash by discounting. As there is no market in New York for commercial paper, it would prove harder to discount the acceptance of an American bank than that of a European institution. Moreover, the best known American banking institutions, the national banks, are not permitted to make acceptances. In consequence, the American importer can not obtain or use to advantage the acceptances of an American bank in settling for his purchases abroad.

*The credit instrument mostly used in the United States is the simple promissory note, and not as in Europe, the draft issued by the seller on the buyer, and generally accepted by the latter. Such a draft, being secured by more than one signature, is a better security than the mere promissory note, and therefore more marketable.

He must call in the services of the English, German, or French banker.

The American exporter, in turn, does not receive in settlement for his merchandise a bill of exchange made out in dollars and cents drawn on an American bank, but one on some European institution, located in London, Berlin, or Paris. He must give preference to a draft on foreign bankers, for their international reputation, and the long established market for bills in those countries, makes it easier to negotiate drafts on them. Naturally European bankers must be compensated for their services, and the commissions and discounts paid out to them every year mount up to large sums. If we had a well organized market for commercial paper, the amount that now accrues to European bankers would remain in America.

At the same time our banks would have a better investment for surplus funds than they have today, and would be in a position to pay their depositors higher rates of interest. Banks receiving deposits from all classes of people must always be prepared to pay out varying amounts to their depositors in cash. They can hold themselves in readiness for such calls by keeping on hand a certain proportion of their deposits in currency, or by placing some of their funds in investments that can be immediately converted into money. It is unprofitable to hold cash, for it yields no income. Banks, therefore, try to keep their stock of money down to the lowest point compatible with the legal requirements and business needs. They seek to invest funds to be held in readiness for possible demands, in securities that can be immediately converted into cash. For, no matter how small the return, this is more profitable than to hold idle money in the vaults.

In countries having central banks, commercial paper is

the most desirable investment for such surplus funds. There a bank can always convert its paper into currency by applying at the central bank or its branches. In the United States, commercial paper is not an attractive investment for funds subject to call at any time, because there is no general market for commercial paper and no central bank to give its circulating notes in exchange. The significance of these conditions for business is far-reaching. The European system, with central banking and a general money market for commercial paper, means that the available funds of the country are employed to discount bills originating with farmers, manufacturers and merchants, *i. e.*, they are devoted primarily to the uses of productive industry. Such investments are unavailable here for the banks. The result is that the largest part of the surplus funds of the country is necessarily used in connection with the stock exchange, that is, for speculative purposes. Call loans, secured by stock exchange collateral, are the only form of investment that begin to meet this need of American banks. They are not as satisfactory as commercial paper, where a market exists for discounts. Still, in cities having a stock exchange with a large volume of transactions, call loans combine a high degree of safety with the advantage of being readily convertible into cash. This, of course, is true only under normal business conditions.

For this reason the surplus funds of banks from all parts of the country are poured into the large financial centers to be invested in call loans. As New York is the chief center, the surplus money of the country is concentrated there, and forms the basis of Wall Street's financial domination. In the last analysis, it is the absence of a well organized national market for short time loans, represented by commercial paper and discounts, which gives Wall Street the control of the ready cash of the nation. The influx of money at

the important stock exchange centers is frequently so great that it can not be used to advantage. This is particularly true of New York, where it results in the abnormally low rate for call money during certain months of the year. The money will either tend to stimulate an unhealthy speculative movement on the stock exchange, or will be loaned out in foreign markets.

At times there is an abundance of money for stock exchange purposes or for export abroad coincidently with a scarcity of money at many points in the interior. Business men and farmers in those sections are unable to secure accommodation, or obtain it only at excessive rates, because the securities which they can give are not an attractive form of investment for the surplus funds of the banks. The development of such districts is thereby very seriously hampered. What is more, producers are at times compelled to sell their staples at a sacrifice, because they can not secure advances to enable them to hold their commodities for a better market. Our farmers are frequently forced to sell their leading staples, cotton and grain, to Europe, at extraordinarily low prices, often even at a loss. The defects in our credit system injure the individual producers directly; ultimately, however, this means that we give away to Europe a vast amount of our national wealth. With a better organized credit system, and with an influential central institution to guard against a misuse of its facilities for speculative purposes, this loss could frequently be avoided and the country as a whole benefitted.

III. Crisis of 1907

The many defects of American banking and currency have shown themselves repeatedly in the course of the coun-

try's industrial development. The crisis following the great movement of industrial expansion which culminated in 1907, revealed, more clearly than ever, all the faults inherent in the present system. Outwardly the cause for the disturbance in the banking system was the widespread rumor that one of the old banks had suffered serious losses through the collapse of a curb brokerage house,* and that it was in a dangerous condition. An investigation proved that the bank was sound, nevertheless the rumors led to runs on several New York banks. The clamor of depositors for their money would not of itself have thrown the banking system into confusion, nor brought about suspension of payments. These results were due more largely to the action taken by banks in various sections of the country than to the conduct of individual depositors.† Fearing a run, the banks made every effort to hold all the cash they had, and at the same time tried to add to their stock of money by calling in their deposits with other banks, notably funds in the hands of agents in reserve and central reserve cities. Their action tended to intensify public distrust, and to call forth a general demand for cash from depositors. The outcome was the panic. The banks naturally could not meet the universal demand for money, and in a short time currency began to disappear from circulation.

While this was the situation, there was actually in the possession of the banks, scattered all over the country, \$550,-000,000 in gold. Had this enormous gold reserve been in the control of some central agency, which could have used it as the basis for additional currency to meet the demand in different localities, it is not at all probable that the fears

*Many stocks not dealt in on the New York Stock Exchange are traded in on the "curb" by houses confining themselves to this class of business.

†Cf. George E. Roberts, Director of the Mint, "The Next Reform—Banking." *Everybody's Magazine*, Vol. xxvi, No. 3, March, 1912.

of depositors would have become so widespread or that the runs on the banks would have assumed the proportions of a national calamity. With the existing dispersion of the gold reserves, and the unbending requirement of the law that a specified percentage of deposits must always be kept as reserve in cash, no money was available for depositors.

The banks had an abundance of good assets, but there was no way of converting them into cash. The note circulation of the national banks could not be increased rapidly enough to supply the need for additional currency. The government tried to help out the situation, and permitted banks to substitute other securities for federal bonds protecting the deposits of the government. This action made the released government bonds available as a basis for issuing additional bank notes, but it could not have any immediate effect. The problem at such a time is to pay off promptly as many depositors as possible, and thereby to restore confidence in the solvency of the banks. Depositors will then cease to demand payment, and in a short time the money withdrawn is returned to the banks.* In the case of the panic of 1907 the effects of the steps taken to increase the circulation did not show themselves until after two months, and then the entire increase in circulation amounted to only \$46,000,000. It was too late; the crisis was past. More-

*A striking illustration of the efficiency of a central bank under such circumstances is furnished by the experience of the German Reichsbank in 1901. An old bank in Leipsic, enjoying a high reputation, had failed as a result of the misconduct of the management. Public confidence was shaken, and a run began on another important bank. As this institution was sound, the Reichsbank and other banking establishments came to its rescue, placing a large amount of cash at its disposal. The money drawn out of the bank by frightened depositors was brought to the Reichsbank. Thus, within a few days, the central bank received for deposit the money which it had advanced. The position of the Reichsbank was in no way weakened by its action in helping the threatened institution. On the other hand, its prompt assistance served to confine the run to a single locality. Confidence in the central bank served to avert runs from other banks, and prevented a general panic.

over, the additional amount of bank notes was totally inadequate to meet the need.

In October, 1907, in the absence of any means for expanding the circulation the banks had no resource but to suspend cash payments. After a little while they proceeded to meet the situation by issuing checks drawn on themselves. These were made out in amounts as low as one dollar and were accepted in trade in lieu of money.

In a great measure these makeshifts proved impractical, and in the large cities the banks united for concerted action through their clearing houses. On the collateral of securities deposited by the banks, clearing house certificates were issued, and these took the place of the bank notes and other currency, which were not to be had. In this way some of the assets of the banks were rendered liquid. The latter received the clearing house certificates in return for good collateral pledged with the clearing house association, and only up to 75 per cent of the value of the securities hypothecated. The acceptance of the certificates was of course not compulsory, as they were without legal sanction. Nevertheless, they were generally accepted, inasmuch as they were guaranteed jointly by all the clearing house banks.

After two months the crisis was ended. Cash was brought into circulation through the efforts of the Secretary of the Treasury, through importation of gold from abroad by leading New York bankers, and as a result of the forced exports of American products. But during these months of the panic, immense harm had been done. Many banks were forced to suspend payment forever, and merchants and manufacturers, unable to secure necessary working capital to continue business, were obliged to shut down, and their employees found themselves without work.

An inquiry addressed by Mr. Andrew* to banks all over the country, shows definite figures for \$334,000,000 of emergency currency issued during the panic. The classification is as follows:

TABLE 3—EMERGENCY CURRENCY ISSUED DURING THE PANIC, 1907
(in millions of dollars)

Classification	Amount
Clearing house certificates:	
Large denominations	238
Small denominations	23
Clearing house checks	12
Cashiers' checks [marked "payable only through the clearing house"]	14
Manufacturers' pay checks [drawn on a bank and generally marked "payable only through the clearing house"]	47
Total	334

Mr. Andrew estimates the *total* issue of substitutes for cash above 500 hundred millions of dollars. The largest amount outstanding in a single city is reported for New York—\$88,420,000 on December 16, 1907.

Tardy and incomplete as were the measures taken by the clearing house banks, they did bring some relief. Analyzed, their procedure was essentially not different from the method employed on the Continent to bring into existence supplementary currency, whenever the need arises. On the deposit of good collateral, which the bank could not realize upon, credit instruments were issued under the name of clearing house certificates. These passed as currency. If we substitute for the securities and claims hypothecated by the banks, the bills of exchange which Continental institutions pledge with their central bank, we can see how closely the clearing house certificates, issued during our panic, corre-

*A. Piatt Andrew: "Substitutes for Cash in the Panic of 1907." *The Quarterly Journal of Economics*, vol. xxii, pp. 497-516, Boston, 1908.

spond to the European bank notes. The difference lies in the method of execution. In Europe the process has been made into a regular system, working automatically. It comes into play early, before conditions have become critical, with the result that panics are, as a rule, forestalled and averted. In this country, however, the clearing house certificate is born of distress. It comes into existence during panics, and appears on the scene when it is too late. At best it serves as a palliative. Clearing house certificates are unequal to the situation and can not adequately cope with it.

As a result of the crisis of 1907, legislation, known as the Aldrich-Vreeland Act, made provision for the issue of similar certificates in the event of another panic. This act, in effect, sanctioned the steps taken by clearing house banks, and made corresponding action legal for the future. The organization of currency associations is provided for, and these are authorized to issue certificates in emergencies. These certificates bear the guaranty of all the banks belonging to the association, and are issued to them on pledge of security with the association.

It is improbable that the action thus provided for will prove an adequate remedy, chiefly for the reason that, as in the clearing house certificate system, measures for relief will be taken too late. Experience shows that to safeguard the currency system, and to expand it to meet the need, action must be taken in the early stages, else the resulting confusion and disaster can not be avoided. This was realized by the authors of the Aldrich-Vreeland Act, and the measure was advocated by them only as a makeshift, to remain in force until a definite and final plan could be worked out and adopted.

B. The Main Features of Continental Banking

The problems of banking and currency which are still before this country, have in a large measure been solved on the Continent of Europe. Conditions here doubtless differ widely from those abroad; nevertheless we may learn much from European experience and example. We accordingly continue with a sketch of the Continental system and its operation in order that comparison may be made between it and the system in the United States.

I. Centralization and Elasticity of the Note Issue

The organization of the Continental banking system is in its characteristic features the opposite of the American system. The note issue is practically restricted to a single institution. To the same institution is also entrusted, for the most part, the guardianship of the cash reserves of the banks and also of other important business institutions. The cash or gold reserve of the country is thus concentrated and under centralized control. The central note bank is not as a rule purely a state institution; it is, however, closely related to the government, and its business is under governmental regulation.

The great mass of banks have no right to issue notes, but in other respects their business is practically left unregulated. Neither their cash reserves nor their activities are subject to restrictions such as prevail in this country.

Such regulations apply only to institutions created for a specific purpose, as for example, the mortgage and the savings banks. Practically all the banks have business relations with the central note bank, either directly with the central institution located at the national capital, or with one or more of the branches established in almost every city of any size or importance. Whenever the cash resources of a bank prove inadequate, it turns to the central bank, which, as a rule, is able to satisfy the need, because it can create additional currency through the issue of circulating notes.

The security on which notes are based makes the circulation of the central bank very flexible and easily adaptable to business needs. Notes must be covered, in part, by a specified reserve in lawful money. So far as the notes are not secured by cash reserves, they are based on short time securities having their origin in commercial transactions, in other words, on bills of exchange. Manifestly notes of such a character relate themselves most closely to the changing conditions of business activity. When trade is brisk and there is a greater demand for currency, bills are offered for discount or rediscount at the central note bank, and it issues in exchange its notes, which serve the purpose of money. Of course, this is conditional upon the central bank having on hand a sufficient cash reserve. It is, therefore, necessary that the central bank keep always an adequate amount of money, in order that it may be able to expand the note circulation as the need arises, and also, at all times, may be prepared to redeem its notes in gold or lawful money. In this way, it satisfies the wants of business, and maintains the confidence in the bank, which is fundamental, if its notes are to meet with universal acceptance.

With this system of security for notes they will not remain in circulation longer than they are needed. The bills

which constitute the collateral for them, fall due in a very limited period, within three months at most. As the bills mature, an equal amount in notes or in cash is repaid to the bank. The circulation is thus diminished either directly by the return of notes or indirectly by payment in cash. The latter reduces the amount of outstanding notes not fully covered by cash, and is the same, in effect, as if the notes were retired from circulation. The note circulation thus contracts, as the bills discounted fall due and are paid off, unless business activity continues and new bills are offered for rediscount, in the same or greater volume.

Through expansion and contraction, the circulation is adapted to the greater or less need for money in carrying on business. The bank note currency comes into existence coincidently with the demand, and disappears as soon as the need has passed away. The result is that the circulation is successfully adjusted to the fluctuations in the seasonal demand for money during the year.

No less effective is the system in meeting the varying needs that arise in the course of a business cycle. The flexibility of the note circulation, and the concentration of the country's gold reserve in the central bank inspire public confidence in the ability of the latter to cope with any situation. As a result, the transition from a boom to a period of depression is usually made without panic.

Experience shows that even during a crisis the demand for credit, and the need for cash is not the same in all districts of the country, nor in every branch of business, nor among all banks. So long as the central bank enjoys public confidence, it is in a position to direct its energies and resources to the point where they are momentarily needed. Meanwhile, funds are flowing in upon it from other sections where the demand for cash is normal. Even in districts in

which there may be a run on local banks, the central bank usually receives the very money drawn out from the institutions that have lost public confidence. This money is generally handed over to other banks and deposited by them with the central institution, or it is entrusted directly to the latter. Thus the strength of the central institution is maintained and augmented.

The central bank is always in a powerful position, ready and able to help, because it can utilize its cash reserves and its note issue to the best advantage. Hence the complete confidence reposed in it, not alone by the banks and other business establishments, but also by the public in general, and the universal feeling that the central bank will prove able to cope with any increase in the demand for funds so long as it is managed well. It is appealed to for help as soon as an increased demand for credit or money arises, and it is always ready to respond promptly to the needs of the situation. Its service to the country in critical times can not be overestimated. The general public is led to make a run on banks, not because of any actual need of funds, but because of loss of confidence. So long as confidence is maintained in the banks, unrest will not become general. Where the public feels that the central bank is powerful, and can be relied upon to come to the rescue of the banks, there will be no general panics.

II. The Money Market and the Note Circulation

There is a striking contrast between the European and the American situation as regards facilities for making short time loans. In the great industrial countries of Europe, there has been developed, alongside of the central note bank, an active and far-reaching money market for short time

loans and the discount of commercial paper. Its facilities are not merely for the stock exchange, or for a few great firms; they are equally open to all business men whose credit is good. The avenue through which the services of the money market are made available to all branches of business is, primarily, the discounting of bills.

The money market, particularly in the great business centers, is national in its scope. Here are concentrated the available funds of the country, and here too converges the demand for money originating in various sections, and coming from different industrial interests. By means of discounts in such a money market, the surplus funds or floating capital of the country are equitably distributed and are used to best advantage. In Europe short time loans are made, for the most part, in discounts. This form of credit offers the greatest facilities to productive industry. Besides the current account credit, it is the chief source from which trade and industry draw the working capital required for limited periods.

Discounts have no inconsiderable advantages over book credit. The merchant or manufacturer selling goods to be paid for, let us say, in three months, usually takes in settlement the acceptance of his customer, the so-called merchant's or customer's bill, payable in three months. In some trades he receives the acceptance of his customer's bank. Owing to the strictness with which the negotiable instrument act is enforced, the bill is almost certain to be paid promptly at maturity. Meanwhile the business man who has taken the acceptance can safely count on receiving his money on a fixed day. Should he find himself in need of ready cash before the acceptance matures, it is a convenient means of raising money. He can discount the bill at his bank, or at the central bank; that is, he can get in cash the face value of his bill, with a slight deduction for discount at the prevailing

rate. In the illustration here used, the bill enables the merchant to convert into cash claims for merchandise sold, some time before the account is due.

Other uses of the bill, more particularly in the form of the bank acceptance, are of even greater importance. They enable the producer to secure cash advances on commodities which have not yet been sold. Many manufacturers are obliged to buy their raw material at certain seasons, and long in advance of the time for the delivery of the finished product. Often their available funds are inadequate for the purchase of raw material, for their capital may be largely tied up in stock or in outstanding accounts. A manufacturer can, however, get credit by pledging the stock of raw material or other assets to guarantee his draft, which will then be "accepted" by his bank. This bank acceptance can be discounted at any bank, or in the so-called "open money market."

A similar use of credit based on bank acceptances serves to enable the producer of staples to hold his commodity for a more favorable market, at a time when it is possible to sell only at ruinous prices. By securing an acceptance from his bank, as in the foregoing case, and having it discounted, he is in a position to get an advance, enabling him to meet current obligation while waiting for more favorable prices. Finally, as noted before, bank acceptances play a very important rôle in settling international transactions.

The rate of discount on a bank acceptance is always dependent on the reputation of the institution making the acceptance. As a rule it can be discounted below the "official rate." The paper of merchants is generally discounted at the official discount rate of the central bank. This is about the average rate on bills for the country as a whole. At this discount rate, "merchant's bills" will usually be taken not only at the central bank, but at other banks as well.

Loans based on bills are as a rule cheaper than credit on

current account. The reason is obvious. Banks find discounted bills very desirable investments, and especially well fitted as an investment for funds subject to call at any time, which must therefore be held in liquid form. The law makes it almost certain that bills will be paid on time. In this respect credit on notes differs from credit on current account with its less definite time for repayment. There is the further consideration that banks can use their stock of bills to secure cash. They can rediscount them with other banks that may have surplus cash on hand and in any event, bills can be converted into currency at the central note bank.

In the large stock exchange centers, transactions in domestic bills, loans on stock market securities, and trade in foreign bills of exchange, all taken together are designated as the "open money market," or, in a more restricted sense, "the money market."* This in contradistinction to the money market in its broader sense, used to describe the entire range of financial transactions. The open money market is the culminating point of the money market as a whole. The standard bills discounted in the open money market are so-called "private discounts." These are exceptionally good prime bills, and represent paper bearing the acceptance of one of the few first-class banks enjoying an international reputation. The rate of discount on such bills is the so-called "private" rate of discount, which is lower than the official bank rate, or the prevailing rate for bills in general. It is also lower than the rate for other bank acceptances. These are discounted at different rates, depending on the name of the bank making the acceptance, and ranging between the

*In the following pages we use the expressions *open money market* or "*the money market*" to designate the restricted money market as distinguished from the money market in its broader sense or *general money market*, as above defined. The term *money market* (without quotation marks) applies to both, to the open as well as to the general money market.

“official” and the “private” rate of discount. Transactions in private discounts and the private rate of discount set the norm for the general discount market. Herein is the importance of the open money market.

The “money market” makes possible an intensive and economical utilization of the surplus funds of the country. Funds for which there happens to be no profitable local use flow into this market from all sides. Here too, centers the demand for credit, which can not be met in the part of the country where it originates. This demand generally expresses itself in bills presented for discount. In the adjustment of supply to demand, which takes place in this way every section of the country and every branch of industry finds its wants satisfied. The equalization in the demand and supply of bills is effected through the banks in the stock exchange centers. Their activity in this field serves to unite all sections, bringing together particularly the remoter districts and the financial centers. Such an adjustment is essential if there is to be a regular market for the bills emanating from all parts of the country.

As a rule there are always banks in the general as well as in the open money market, with funds from one section or another, prepared to buy bills. They are less hesitant to do so, because, should they need money, they can easily place these bills with other banks, and in any event rediscount them at the central bank, where cash is always obtainable in exchange for good paper. The existence of the central bank is thus the last resort of the market for discounts in general and of the open money market in particular. The ultimate support offered by the central bank is indispensable for the safety of the individual banks. Without it there could be no extensive development of a market for bills, and the money market in the narrower sense, as here de-

scribed, could not exist. For the central bank, on the other hand, participation in the discounting of bills is the means of keeping in touch with the industrial movement of the country. The intimate relation of central bank and money market explains why it is that in the United States there is no regular market for commercial paper and no well organized general money market. The most important condition for such a development is wanting, *viz.*: a central banking institution with the right to issue notes.

III. The Policies of Central Note Banks

The relations between the financial transactions of a country, and its central note-issuing institution, and more particularly, the relations between the latter and the "money market" are, as we have seen, very intimate. It is this close connection which enables the central institution to influence credit and thereby to exert a vital effect on the industrial life of the nation. As an institution of semi-public character, it ought not use these powers for private benefit, but for the advancement of public interests. In its business policies the dictates of private profit must yield to the public good; the general interest of the country must be the keynote of its policies and decisive in all doubtful cases. In practice the great European note banks have not been found wanting, and in all their activities have considered the welfare of the country as a whole before all else.

The functions assigned to the central note banks may be described as the "regulation of the monetary and credit system." It is the duty of the central bank to meet the needs of the country for currency both under normal conditions and in emergencies. In the relations of the country to others, its task is to maintain the credit of the nation.

The credit of any country depends primarily upon the maintenance of its monetary system, the immediate redemption of circulating notes in cash, and the prompt fulfilment of its obligations to foreign countries. Such indebtedness may be paid off with claims on other countries, or, when these do not suffice, by sending the only other medium of international exchange, namely, gold. In order that a country may be able to discharge its obligations at all times, its central bank must make every effort to keep on hand as large a stock of gold as possible, to be used, if necessary, for the redemption of its own notes, or for meeting obligations to foreign countries, when trade conditions so require.

The variations in the central bank's stock of gold are in the last analysis bound up with the general condition of business activity. In turn, the character and extent of trade movements will determine largely whether or not the central bank will be able to discharge adequately its functions as the regulator of the country's monetary and credit system. The interconnection between trade and the money market, and their relations to the central bank make it necessary for the latter to take an active part in shaping the country's industrial movements. As these are in a great sense dependent on the money market, the central bank is in a position to influence them, through exerting its power on the money market.

The fundamental principle in the policy of a central bank, therefore, is to build up its resources as much as possible, while conditions are normal. Only in this way can it prepare for emergencies and abnormal demands for money, and hold itself ready to furnish the help urgently needed on such occasions. Thus it is a matter of much concern to the central bank that the pace of industrial activity should not

become overhasty. When the demand for credit expands too rapidly, the bank seeks to check the movement by raising the discount rate. Its object is to make credit dearer, and to reduce the demand for money by discouraging borrowing, when the need is not urgent, thereby also protecting its own resources.

The success of such a discount policy as a preventive measure, depends largely on the central bank's ability to make its discount rate effective, and to enforce it in the money market. Another and important condition of success is that action should be taken by the bank early enough to check the overexpansion of credit. If the bank intervenes too late, and expansion of credit has gone too far, the efforts of the central bank are more or less futile. Under such conditions it must act cautiously. The rate of discount must not be raised too suddenly, and the bank must not go too far in refusing credit, in order to restrain the movement of expansion by force. It is unsafe to do so, even though the boom may originate wholly, or in part, in speculative movements, and may be without substantial foundation. By resorting to harsh measures in an advanced stage of overexpansion, the central bank may do more harm than good, and its action will serve only to hasten the crisis, and to make it more acute. The function of the central bank, on the contrary, is to prevent a collapse, or at least to moderate its violence.

At the culmination of a boom, when the turn towards a period of depression is at hand, the bank will make every effort to prevent a sudden breakdown which is likely to involve serious injury. Its energies must be bent to the task of making the transition to a condition of industrial depression more gradual. In contrast with its earlier policy of restriction, the bank will make advances to establishments of high standing, in order that they may not be compelled to

sacrifice their products at ruinous prices, and to shut down their plants, and throw their employees out of work. The duty of the bank is to supply sufficient credit to enable the business world to find itself again, and to resume its normal course. Only in this way can it prevent a general industrial collapse, and minimize the evil effects of the crisis.

When the demand for credit abates, the bank quickly feels the growing ease in the money market; fewer bills are offered for discount, and the amount of its outstanding notes declines accordingly. The central bank takes account of the situation and meets it by gradually reducing its discount rate. The chief consideration here is that the business community should not be burdened by too high a rate of discount, tending to increase production costs.

Such action is also dictated by the necessity of the central bank maintaining its influence over the money market. If the difference between the official bank rate and the market rate becomes very great, the central bank will cease to be in close touch with the money market. The great bulk of bills offered will be discounted by the private banks; few will come to the central bank, and its hold on the situation will be weakened. The central bank must do everything to avert such an outcome. It can not influence the industrial situation unless it is always in close contact with the money market, perceives all important changes promptly, and is, at the same time, in a position to make its rate of discount effective. Only through intimate relations with the money market and industrial movements can a central bank obtain the necessary insight into particular situations and the general conspectus which it must have at all times if it is to be in a position to give its support in money stringencies, where and to whom it is due, and lend its credit to those deserving of it.

The importance of keeping in touch with the market is universally recognized. When the conditions are such that

the central bank does not deem it advisable to lower its own rate of discount, it will try to reduce the margin between its rate and the rates in the money market to a normal point (more particularly, between its rate and the private rate of discount) by working for a higher market rate. To illustrate: The central bank may be of the opinion that the prevailing ease in the money market has no real foundation, that it is due only to a momentary oversupply of funds caused, let us say, by the temporary inflow of money from abroad. Under such conditions the central bank will not reduce its rate. On the contrary, by coming into the market as a borrower, it will try to prevent a further decline in the private rate of discount or to force up this rate, on which the other rates more or less depend. In Germany, for example, the Reichsbank rediscounts treasury bills, *i. e.*, the short time notes of the government, on the Berlin stock exchange, where they are always taken at the private rate of discount. If the central bank has a large supply of such securities on hand it can use them to increase the demand for money in the open market by offering them for rediscount. It thus forces a higher private rate of discount. This is effective if the ease in the money market is not universal and does not rest on fundamentally sound conditions. If, however, the central bank should have been mistaken in its diagnosis of the situation, its action will not raise the private rate of discount to a higher level. It may even fail to prevent further decline. The central institution will then be obliged to reduce the official rate to correspond with the conditions in the money market.

The policy pursued by the central bank is shown clearly in the movement of the official rate of discount. The changes in the course of the year as well as those in the progress of the larger business cycles can readily be followed

in detail. Soon after the beginning of the year the discount rate reaches a relatively low point. Then it gradually rises, attaining the high mark towards the last quarter, when as a rule the demand for money is greatest. The rate continues on a relatively high level into the next year. In January or February a low point is again reached. Then the movement as described is repeated.

The same development can be seen on a larger scale in the progress of a business cycle, if we look at the average rate of discount for a considerable length of time. When a period of trade activity opens, the rate of discount is low. As conditions improve, the discount rate is carried along to higher marks. The normal fluctuations in the course of the year continue as before, but on a level that is higher from year to year. The decline of the rate of discount during the period of easy money in any year is not as great as the subsequent rise in the rate, with the result that, though its course may be interrupted, the average rate of discount rises as the boom progresses. The discount rate reaches its culminating point about the time when the crisis comes. It remains on a high level for a considerable period, until the obligations entered into at high tide have finally been liquidated, and the dangers of the crisis have been passed. From that time on, the bank rate gradually declines, until it reaches a point below which the official rate does not fall.

IV. Publicity

It is clear from the foregoing discussion that with skillful management a central bank is in a position to exert a decisive influence on the industrial activity of the country. We naturally inquire how the abuse of such power is to be guarded against. This is achieved, in part, (1) by exercis-

ing great care in the make-up of its administrative staff, (2) by creating advisory committees constituted of business men, expert in their lines, (3) by enacting strict laws regulating the conduct of the business of the central bank, and lastly (4) by publicity.

The best and most effective device for controlling a central bank is publicity. This is enforced by requiring public statements at brief intervals, usually once a week, giving the details of the bank's assets and liabilities. Regular published statements of this kind compel the managers of the note bank to take account of the movement of the bank's business, and to study the significance of the situation confronting them. On the other hand, the reports give the public a means of controlling the bank's activity, and of watching its policies. The opportunities for the abuse of the bank's powers are thereby effectively restricted. Leading newspapers and banking and trade publications print criticisms of the bank's statements, and the activities of the bank are thus discussed from every possible point of view. Similarly, mistakes of policy and faults in details of administration are quickly pointed out, and early correction is made possible.

The importance of publicity, however, is by no means exhausted with its use for purposes of controlling the policy and business administration of the central bank. It becomes a regulator of the money market and thereby of business as a whole. The bank reports, or rather the conditions revealed by them, today form an index and a guide for business activity in general, and help to prevent speculative over-expansion. While bank publicity does not always serve to accomplish this fully, it is usually an effective restraint. The variations in the different items appearing in the bank statement enable the careful observer to form an almost accurate

opinion as to the extent and the character of the dependence of business, directly or indirectly, on the resources of the central bank. Its statements reflect the conditions in the money market as a whole, and this in turn serves as a reliable index of the general industrial situation. Naturally, countries having a well organized money market and an active central bank, give the closest attention to the statements of the latter. This applies not only to bankers and persons directly interested in the money market, but to business men generally. All of them find material to guide their action in their own lines of business in the figures of the bank statement.

An example will best illustrate the degree in which these statements reflect the policy of a central bank, the adaptation of the note circulation through expansion and contraction to meet business needs, and the changing conditions in the

TABLE 4—IMPORTANT ITEMS, STATEMENTS OF THE
GERMAN REICHSBANK, SEPT.-OCT., 1911
(in millions of dollars*)

1911	Sept. 23	Sept. 30	Oct. 7	Oct. 23
Liabilities:				
Outstanding notes	\$399.3	\$546.3	\$487.1	\$429.9
Deposits	184.1	154.7	153.1	152.8
Assets:				
Cash	264.6	236.9	239.6	261.0
Bills discounted	296.7	424.9	359.6	289.0
Loans on collateral	12.1	21.6	14.9	14.5
"Securities"	6.0	28.1	37.2	31.4
Ratio of the cash reserve to outstanding notes, per cent	66.3	43.4	49.2	60.7
"Uncovered" notes	\$134.7	\$309.4	\$247.5	\$168.9
Net credit demand	124.7	291.8	221.4	150.7

*100 Marks = 23.8 dollars

money market. The weekly statements of the German Reichsbank may be taken as typical. They are particularly instructive, as showing the constantly changing needs for money and credit, and the co-extension of the credit system with varying conditions in a country which has undergone enormous industrial development during the last few decades.

In general these figures show that between the 23d and 30th of September 1911, the resources of the bank had been impaired, but that during the first week of October an improvement had already taken place. The increasing weakness during the last week of September signified that the credit needs of the country were much greater than the resources available in the general and in the open market. Accordingly, the central bank was called upon to supply a large amount of currency, which it did by expanding its circulation from \$399,300,000 to \$546,300,000 [Increase: \$147,000,000] and by paying out in addition a large amount of money. Thereby it reduced its stock of gold and other coins from \$264,600,000 to \$236,900,000. [Decrease: \$27,700,000.] The circulating medium of the country had thus been enlarged by approximately \$175,000,000 in the course of the week.

This increased need for money was due to the moving of the crop and the settlements at the close of the third quarter. The demand made on the central bank for currency can be expressed by a single figure: the amount of notes outstanding in excess of the cash or gold reserves of the bank, the so called "uncovered" notes. The absolute amount of notes outstanding is of no special significance, for much of it merely takes the place of money held in the vaults of the central bank. To the extent that notes are issued for gold, there is no increase in the circulating medium of the country, notes being used for convenience in place of coin. The currency expands only to the extent that notes are issued with-

out any corresponding increase in the metallic reserves of the bank. The so-called uncovered circulation, or excess of notes over cash reserves, was \$134,700,000 on September 23d; on the 30th it had risen to \$309,400,000, indicating that the bank had satisfied the demand for additional currency to the extent of \$175,000,000 as shown above.

The increase of the note circulation and decrease in the metallic reserve meant that the condition of the central bank had been weakened. The percentage of the cash reserve, or ratio of metallic money* to the outstanding note circulation, fell from 66.3% to 43.4%. Inasmuch as the Reichsbank is obliged to maintain a minimum cash reserve equal to 33 1-3% of its outstanding notes, the rapid reduction of its reserves indicated the need of caution by the bank, and the possibility that it would before long be compelled to increase its rate of discount, in order to check a further expansion of its note circulation.

Further, the details of the bank-statement show in just what form the different elements in the business community secured their accommodation from the central bank. Primarily this was done through the discounting of bills and borrowing on collateral. The amount of bills held by the bank increased \$128,200,000 (rising from \$296,700,000 to \$424,900,000), collateral loans increased by \$9,500,000 (from \$12,100,000 to \$21,600,000). Moreover the customers of the Reichsbank had drawn on their free "giro" deposits; that is, deposits in excess of the required minimum for the right to have a "giro" account.† During the week in question "giro" deposits fell off by \$29,400,000 (from \$184,100,000 to \$154,700,000). The differences in these three items express the changes in the relation of the Reichsbank to its customers.

*Including about \$15,000,000 of *Reichskassenscheine*—government notes issued to replace the paper money of the several states upon the formation of the empire. Not legal tender but acceptable by the government for taxes, etc.

†For further account of the working of the giro system consult page 91.

The absolute figures indicate the extent to which the business community is indebted to the central bank. Bills and collateral loans (amounting on September 23d to \$308,800,000) represent in general the gross indebtedness of the community; deposits (amounting on the same date to \$184,100,000) stand for the amount due to it by the note bank. The difference (amounting to \$124,700,000) shows the net amount of credit extended by the central bank. During the week under discussion, the increase in the amount of credit granted by the central bank was \$167,100,000.

After the settlements for the third quarter had been effected, money began to flow back into the bank. The beginning of the movement showed itself in the statement of October 7th. During October, repayment of loans was rapid, as is usually the case in that month. The statement for October 23d shows the change in the situation very clearly. As compared with the figures for September 30th, when the outstanding circulation was highest, the figures at the end of the third week in October indicated that \$135,900,000 of bills and \$7,100,000 of collateral loans had been paid up. Part of the funds for this purpose had been taken, however, from the "giro" deposits, which show a decline of \$1,900,000. The net demand for credit, as shown in the excess of the amount of bills and collateral loans held by the central bank over the deposits of the business community, amounted to \$150,700,000. It had been reduced by \$141,100,000 as compared with the figures on September 30th, and was thus on October 23d only \$26,000,000 higher than four weeks previous, just before the settlements for the third quarter. It is clear that the additional credit requirements at the end of the third quarter had been for the most part repaid by the close of the third week in October. The business community had reduced its indebtedness to the Reichsbank in the main by returning its notes and by paying

in coin. The bank's holdings of metallic money increased by \$24,100,000, its outstanding circulation declined by \$116,400,000. The note issue not covered by the bank's stock of cash had declined from \$309,400,000 on September 30th to \$168,900,000 on the 23d of October, a reduction of \$140,500,000. The ratio of cash reserves to outstanding notes had risen in consequence from 43.4% to 60.7%. *Thus where the central bank and the money market work hand in hand, the note circulation of the bank is automatically expanded and reduced in keeping with the currency needs of the business community.*

The condition of the Reichsbank is at times affected also by changes in its so-called "securities" account. This is made almost entirely of short time treasury bills, representing borrowing on the part of the government in anticipation of the collection of its regular revenues. The variations in the "securities" account have only a remote connection with the movements of trade and are of secondary importance in studying the condition of the money market. The transactions under this head are important only when the government borrows freely from the central bank. If the needs of the government come at a time when there is a large demand for credit from merchants and manufacturers, the position of the bank is weakened, as it is deprived of funds which would otherwise have been available for the needs of the money market. On the other hand government deposits often help to strengthen the position of the bank, giving it control of a large amount of funds which it can use in the money market.

In the illustration here taken, the loans to the government were coincident with the large demand from the public. The "securities" account, representing loans to the government, increased from \$6,000,000 to \$28,100,000. In the following week this was no longer the situation. The

needs of the government increased to \$37,200,000, but the requirements of the public declined.

The figures here cited are significant as an index of the condition in the money market when taken in relation to other statements. Before judgment can be passed on a situation and inferences drawn as to probable developments, comparison must be made with movements in previous years, and more particularly with years representing analogous business and financial developments. From a comparative study of bank statements, conclusions that are quite reliable may be drawn in reference to movements both in the money market and in business in general. The details of such a study would lead us too far here. For the present purpose it is enough to show how the bank statements at once mirror the increase in the demand for currency, and the automatic contraction in the note circulation with the falling off in the need for currency. The loans made by the bank are repaid, and the notes are, accordingly, withdrawn from circulation.

The movement, here described in detail for the German Reichsbank, is essentially the same in the case of other banks of issue of similar or like character. As another illustration there are cited below three statements of the Bank of France.* To the official items are added the changes from week to week in the cash reserves for outstanding notes, the net credit demand on the central bank as shown by the excess of loans and discounts over deposits, etc., in the same form as described above in detail.

*The statements of the Bank of France do not usually exhibit the greatest fluctuations. Its reports are for the week ending Wednesday. As the months usually end within the period of the weekly statement there has been a marked recession in the credit demand by the time the next statement is issued in the following month, and the actual tension on settlement dates can only be inferred. For this reason the statements of the Bank of France here used are not those corresponding to the German reports. To emphasize movements more clearly, the statements showing the changes from May to June are chosen, in which the fluctuations are most marked.

TABLE 5—IMPORTANT ITEMS, STATEMENTS OF THE
BANK OF FRANCE, MAY-JUNE, 1911
(in millions of dollars)*

1911	May 26	June 1	Increase or Decrease	June 8	Increase or Decrease
Liabilities:					
Outstanding notes	\$972.4	\$1003.3	+30.9	\$985.3	-18.0
Public deposits	43.3	40.7	- 2.6	32.3	+ 8.4
Private deposits	125.1	111.8	-13.3	120.9	+ 9.1
Assets:					
Cash	790.2	784.8	- 5.4	785.3	+ 0.5
Bills discounted	198.3	233.7	+35.4	199.8	-33.9
Loans on collateral	118.7	118.2	- 0.5	122.2	+ 4.0
Ratio of cash reserves to out- standing notes, per cent:	81.26	78.22	-3.04	79.70	+1.48
"Uncovered" notes	\$182.2	\$218.5	+36.3	\$200.0	-18.5
Discounts and loans	\$317.0	\$351.9		\$322.0	
Private deposits (-)	125.1	111.8		120.9	
Net credit demand (=)	191.9	240.1	+48.2	201.1	-39.0

*100 francs=19.3 dollars.

In contrast with the movements of the note circulation in Germany and France the outstanding notes in the United States show but little variation. All that can be gathered from our bank statements for the same period (1911) is shown in the table below, from which it appears that there was a gradual increase from the close of June to the beginning of August—amounting in all to \$11,000,000.

TABLE 6—OUTSTANDING NOTES OF THE NATIONAL
BANKS, 1911

(in millions of dollars)

May 31	\$732.8	August 8	\$739.2
June 6	728.2	Sept. 9	738.8
July 7	728.5	October 31.....	737.2

Here, of course, there is no question of any automatic expansion or contraction, nor of any adaptation of the volume of notes to the requirements of business.

C. Fundamental Ideas of the Aldrich Plan

Comparison of American banking and currency with that of other countries and more particularly with the highly developed organization on the European continent, demonstrates that our system is obsolete and unsatisfactory. Its complete breakdown in crises together with its general inadequacy establish beyond doubt the urgent necessity for reforms. The creation of the National Monetary Commission was a recognition of the need. After a thorough investigation of banking in all important countries, the Commission reported that the American banking system was thoroughly unsatisfactory, specifying seventeen points in which it was defective. These are here reproduced for the reader's attention:

"1. We have no provision for the concentration of the cash reserves of the banks and for their mobilization and use wherever needed in times of trouble. Experience has shown that the scattered cash reserves of our banks are inadequate for purposes of assistance or defense at such times.

"2. Antiquated Federal and State Laws restrict the use of bank reserves and prohibit the lending power of banks at times when, in the presence of unusual demands, reserves should be freely used and credit liberally extended to all deserving customers.

"3. Our banks also lack adequate means available for use at any time to replenish their reserves or increase their loaning powers when necessary to meet the normal or unusual demands.

"4. Of our various form of currency the bank note issue

is the only one which we might expect to respond to the changing needs of business by automatic expansion and contraction, but this issue is deprived of all such qualities by the fact that its volume is largely dependent upon the amount and price of United States bonds.

"5. We lack means to insure such effective coöperation on the part of banks as is necessary to protect their own and the public interests in times of stress or crisis. There is no co-operation of any kind among banks outside the clearing-house cities. While clearing-house organizations of banks have been able to render valuable services within a limited sphere for local communities, the lack of means to secure their co-operation or affiliation in broader fields makes it impossible to use these or similar local agencies to prevent panics or avert calamitous disturbances affecting the country at large. These organizations have, in fact, never been able to prevent the suspension of cash payments by financial institutions in their own localities in cases of emergency.

"6. We have no effective agency covering the entire country which affords necessary facilities for making domestic exchanges between different localities and sections, or which can prevent disastrous disruption of all such exchanges in times of serious trouble.

"7. We have no instrumentality that can deal effectively with the broad questions which, from an international standpoint, affect the credit and status of the United States as one of the great financial powers of the world. In times of threatened trouble or of actual panic these questions, which involve the course of foreign exchange and the international movements of gold, are even more important to us from a national than from an international standpoint.

"8. The lack of commercial paper of an established standard, issued for agricultural, industrial, and commercial purposes, available for investments by banks, leads to an unhealthy congestion of loanable funds in great centers and hinders the development of the productive forces of the country.

"9. The narrow character of our discount market, with

its limited range of safe and profitable investments for banks, results in sending the surplus money of all sections, in excess of reserves and local demands, to New York, where it is usually loaned out on call on Stock Exchange securities, tending to promote dangerous speculation and inevitably leading to injurious disturbances in reserves. This concentration of surplus money and available funds in New York imposes upon the managers of the banks of that city the vast responsibilities which are inherent in the control of a large proportion of the banking resources of the country.

“10. The absence of a broad discount market in our system, taken together with the restrictive treatment of reserves, creates at times when serious financial disturbances are anticipated a condition of dependence on the part of individual banks throughout the country, and at the same time places the farmers and others engaged in productive industries at a great disadvantage in securing the credit they require for the growth, retention, and distribution of their products.

“11. There is a marked lack of equality in credit facilities between different sections of the country, reflected in less favored communities, in retarded development, and great disparity in rates of discount.

“12. Our system lacks an agency whose influence can be made effective in securing greater uniformity, steadiness, and reasonableness of rates of discount in all parts of the country.

“13. We have no effective agency that can surely provide adequate banking facilities for different regions promptly and on reasonable terms to meet the ordinary or unusual demands for credit or currency necessary for moving crops or for other legitimate purposes.

“14. We have no power to enforce the adoption of uniform standards with regard to capital, reserves, examinations, and the character and publicity of reports of all banks in the different sections of the country.

“15. We have no American banking institutions in foreign countries. The organization of such banks is necessary for the development of our foreign trade.

“16. The provision that national banks shall not make

loans upon real estate restricts their power to serve farmers and other borrowers in rural communities.

“17. The provision of law under which the Government acts as custodian of its own funds results in irregular withdrawals of money from circulation and bank reserves in periods of excessive Government revenues, and in the return of these funds into circulation only in periods of deficient revenues. Recent efforts to modify the independent Treasury system by a partial distribution of the public moneys among national banks have resulted, it is charged, in discrimination and favoritism in the treatment of different banks.”

The faults here detailed can be reduced to three fundamental defects: (1) the inflexibility of our note circulation, (2) the dispersion of our national gold reserve, and finally (3) the lack of a money market or a general market for short time loans and discounts.

We have seen why a well organized money market could not be developed in the absence of a central note bank. An institution of this kind is the absolute prerequisite of a market for short time loans. The failure to organize a money market is in the last analysis the result of the two other defects here noted. The fundamental shortcomings of the American banking organization are thus traceable to our inelastic system of issuing bank notes and to the decentralization of the gold reserve of the banks.

These defects in our organization of credit are recognized in the Aldrich plan as embodied in the bill submitted by the National Monetary Commission with its report. The plan proposes by way of reform to introduce greater flexibility in the bank note system, to concentrate the widely scattered gold reserves of the banks in a central agency, in order that their combined resources may be available for relief in times of crisis, or for use beforehand to avoid the outbreak of panics.

In theory these ends might be best achieved through the creation of a central bank authorized to issue notes. The Commission, however, does not recommend the establishment of an institution of this character, chiefly because existing political sentiment would make impossible the enactment of legislation looking to this end. From the struggles over the first and second Bank of the United States, the country has inherited a deeply ingrained distrust of central banks, which may not be altogether unjustified in view of present conditions. It is undeniable that the centralization of the note issue without adequate precautions against abuse makes it possible to exploit, for selfish purposes, the note circulation, with its tremendous influence on the business activity of the country as a whole.

Objections to a central bank are primarily political. It is feared that a central bank might be used for political purposes, to strengthen the powers of the central government, or to advance the business interest of politicians belonging to whatever party may be in power. There is, moreover, the dread that control of a central bank might fall into the hands of a combination of financial or capitalistic interests, one or the other groups of Wall Street, of which there is widespread distrust, and that it would become an instrument for forcing policies dictated by their selfish interest upon the country. Lastly, there is the American aversion to government interference in private business, and more emphatically in a field which is already occupied by a special class of institutions, subject to governmental regulation. It is naturally assumed that their present function in the issue of notes would be interfered with by a central bank, and their other vested rights perhaps impaired.

These factors all serve to place obstacles in the way of a thorough reorganization of the American banking system. The various forces must be reckoned with, and the endeavor

to reconcile the conflicting interests explains the fundamental ideas underlying the Aldrich Plan and the proposed legislation.

The Aldrich Plan takes account of the situation. It proposes an institution to exercise the functions of a central bank, which shall be so different in form and organization that it will no longer be open to the objection raised against that type of bank. The institution advocated is to be known as the National Reserve Association of the United States (hereafter abbreviated as N. R. A., or referred to as the Association). It is not to be an independent central bank, but an institution formed by the co-operation of the existing banks, uniting in itself the resources of the individual banks for the purpose of increasing their efficiency. To quote the Monetary Commission: "It is not a bank but a co-operative union of all the banks of the country, with very limited and clearly defined functions." And again: "Instead of overshadowing the banks, it is their representative; its controlling forces, acting in the public interests, impose policies upon and grant powers to its managers. . . . It is outside of and supplemental to the existing system and not a competitor in any sense with existing banks. . . . Its dominating principle is co-operation and not centralization."

The Association is not to compete with the banks. To make competition impossible, it is permitted to do business in this country only with the institutions united to form it. These alone may hold stock in the Association, and the profits of the Association up to a certain point accrue to them.

Much skill and ingenuity has been spent in devising a highly elaborated system for the election of directors and officers in the National Reserve Association, and in the constituent local organizations in which all the banks are grouped. The object is to make it impossible for any body

united by political, financial, or sectional interests to secure control of the Association, or of its constituent local units. Provision is further made that one uniform rate of discount must be applied everywhere in the United States. Moreover, the same rights and privileges must be extended to every bank belonging to the Association.

Further changes in the existing banking system are proposed, in order to enable the new institution to discharge the functions usually assigned to European central banks. To create a more flexible note system, the plan proposes the gradual abandonment of the use of government bonds as a basis for bank notes. It contemplates the issue of notes secured by lawful money and by bills having their origin in commercial transactions. Owing to unfavorable legislation, the commercial paper now in use is either too limited in amount to serve the purpose, or of a character that would not meet requirements. Measures are, therefore, advocated to facilitate the establishment of a market for commercial paper or short time loans, with which the Association could work in harmony. The national banks are authorized to make acceptances. Our relations with the international money market are to be drawn closer by permitting the Association to deal in foreign bills of exchange, both in this country and abroad. The way is thus to be paved for the development of a well organized money market for short time loans and commercial paper or discounts.

The plan proposes to establish American banks in foreign countries for the purpose of fostering trade relations and aiding in financing our foreign commerce. National banks are permitted to own stock in these institutions. These banks will enable American capital to secure a firmer foothold in the international money market, and to occupy abroad a position in keeping with the extent of our interests.

The final step towards the establishment of sound financial conditions aims at the concentration in one place, and under one control, of the gold reserve now so widely distributed among the numerous banks of the country. The banks forming the Association are permitted to keep their legal cash reserve on deposit with the Association. The latter is also to act as treasurer for the United States. In these two ways the Association will come into possession of a large amount of gold, which will serve to secure its notes, and will put it in a position to come to the relief of legitimate business interests in the event of a crisis. The plan of the proposed legislation accepts in the main the Continental system. The chief difference is that the Association, as the central note institution, is not a central bank in the European sense.

The details of the proposed legislation have been devised with a view to carry into effect the few fundamental principles as here outlined. The different provisions in the bill have not yet received their definite and final formulation, and they are not altogether systematic in their sequence. Instead of adhering to the order in which the various provisions of the plan or bill are found, we have thought it advisable to arrange the subject matter, in the following discussion, in accordance with the fundamental ideas in their proper sequence.

CHAPTER II

Details of The Aldrich Plan

Details of The Aldrich Plan

I. Charter and Membership

The bill submitted with the report of the Monetary Commission opens with provisions for the incorporation of the National Reserve Association, and prescribes the form of its organization and administrative machinery.

The National Reserve Association is established for a period of fifty years, with headquarters in Washington. The bill gives the Association a charter to do business for a much longer period than is customary in the case of the European central banks. Thus the charter of the German Reichsbank expires at the end of ten years, and must be renewed by legislative act, in order that the bank may continue. Evidently the departure from European examples has been made consciously, because it was felt desirable to insure the existence of the bank for a period long enough to fully establish the desirability or the necessity of the institution in our monetary and banking system. A charter for a long period of years has the advantage of making the continuance of the bank independent of political changes. The question of renewing the charter will be taken out of politics. Certain disadvantages, however, are involved. These are, indeed, minimized by a provision introduced into the bill, reserving to Congress the right to alter or amend the act creating the Association, such modifications of the act to take effect at the end of any ten year period from

the date of organizing the Association. The latter is under this provision given time to prepare for any changes that may be required by Congress, and to adjust its business with as little disturbance as possible. [P. 1; B. 1*.]

It is apparent that with the establishment of the Association a break is made with the old system. Even if we regard the proposed Association as no more than the representative or collective agent of the banks, it must be evident that a new institution is created and the banking system is established on a different basis. In the bill provision is therefore made, properly enough, for the repeal of all acts, or parts of acts, inconsistent with the proposed law creating the association. [B. 59.]

The capital stock of the Association is not fixed at any specific sum. It is to be equal in amount to twenty per cent of the paid in and unimpaired capital of all banks constituting its membership. The amount of the capital stock, accordingly, varies with the capital of the banks uniting to form the Association. Stock can be owned only by national banks, state banks and trust companies. These institutions alone may participate in the Association; they alone (except for the government) may do business with it. These institutions are authorized to own shares of the Association to the amount of twenty per cent of their paid in and unimpaired capital. They can hold no more and no less. On increasing their capital they must subscribe for additional stock in the Association, and on reducing their capital they must surrender a proportionate amount of their shares. [P. 2, 3, 60; B. 3.]

From the statistics published by the Comptroller of the

*In the references "P" designates sections in the revised Aldrich Plan; "B," sections in the Bill submitted with the Report of the National Monetary Commission.

Currency for these three classes of banking establishments, it is possible to arrive at an approximation of the probable capital stock of the Association. The capital of these institutions is as follows:

Class of Banks	Number of Banks	Paid-in Capital
National Banks	7372	\$1,033,600,000
State Banks	12864	452,900,000
Trust Companies	1616	441,600,000
All banks	21852	\$1,928,100,000

The figures for the national banks are as of June 14, 1912, those for the state banks and trust companies as of June, 1911. Later figures are not available for the two last-named classes. Doubtless there has been a considerable addition to the capital for each class, through increase of capital stock and the organization of new institutions. The present capital of all institutions may be estimated at approximately \$2,000,000,000.

If all these institutions were to join the Association, its capital would amount to \$400,000,000. However, not all are eligible. A specified minimum capital is a condition for membership, and this provision would eliminate a very considerable number of small banks. [P.61;B.3.] It was originally contemplated to restrict membership to the national banks. In the revised form of the proposed legislation, trust companies and state banks are admitted on the same terms. Membership is conditional upon ownership of stock in the association, and conformity with the requirements of the proposed legislation.

The draft of the law, as submitted, makes provision only for voluntary application for membership, and for compulsory surrender of membership privileges in the case of bank-

ruptey or voluntary liquidation. The bill is silent on the right of a member bank to withdraw from the Association of its own will. This point is too serious to be left in doubt, for if banks are to have the privilege of withdrawing from membership at their pleasure, the existence of the Association would be made dependent on the good will of the banks. Withdrawal from membership, should, therefore, not be permitted without such restriction as will safeguard the existence of the Association and its uncrippled activity. [P. 2, 3, 64; B. 3, 12.]

Shares of the capital stock of the Association are not transferable, and they can under no circumstances be hypothecated. These provisions make effective the general restrictions on the ownership of stock which seek to prevent any single bank from enlarging its stock holdings in the Association and acquiring undue influence thereby. At the same time, it is made impossible for persons or institutions other than those intended under the proposed legislation to secure a foothold in the Association. [P. 3; B. 12.]

The revised Aldrich plan contemplates for the Association an initial capital of \$300,000,000, of which one-half is to be paid in at once, and the rest is to be payable on demand. The Association would thus begin business with a capital of \$150,000,000, an amount which would put the Association ahead of all existing central banks, as regards capital. This may be seen from the following figures of the three leading central note banks of the world.

Bank of England.....	\$72,800,000
Reichsbank of Germany.....	45,000,000
Bank of France.....	36,500,000

While the capital contemplated in the Aldrich plan is \$300,000,000, this is not the minimum required before the Association can begin business. The bill provides that the

institution may enter upon its work as soon as \$200,000,000 have been subscribed for and \$100,000,000 actually paid in. The ultimate capital can not be readily determined. We may presume that it will be much more than \$200,000,000, for if the national banks alone enter the Association, the capital stock would exceed that figure. Moreover, the capital of the Association would never be fixed at any definite amount. Provision is made for subscription to the capital stock by newly organized banks, or by existing banks, which may later join the Association. Furthermore, as banks belonging to the Association must hold shares of a par value of twenty per cent of their paid-in capital, the capital stock of the Association would increase or diminish with the changes in the capital of the constituent banks. Original subscriptions are, naturally, to be at par, but subsequent subscriptions are to be paid for at book value. In the same way, a bank retiring any part of its capital, receives on the surrender of a proportionate amount of its stock holdings in the Association, the book value of the shares. [P. 3; B. 3.]

The element of variation in the capital stock of the Association is certainly not an advantage. It makes the ascertaining of the capital a matter of complicated calculation. Still this feature of the plan was manifestly dictated by the fear that some particular institution or interest might gain undue influence. If this is to be guarded against, it is hardly possible to avoid a variable capital for the Association.

Similarly, it is impossible to tell how much of the Association's paid in capital will be available for its banking operations. For a period of one year after organization, the Association must purchase at par all two per cent bonds offered to it by the national banks. There is no basis for estimating the amount of bonds which the Association will be called upon to take over from institutions desiring to abandon their circulation privilege. [P. 66; B. 49.]

As the Association is to be a public institution rather than a private business, limits are set to the profits which may be paid out to the share holders. The restrictions imposed on the profits of the enterprise, and the mode of distributing the income, are in general modelled on the plan of the German Reichsbank. The underlying aim is to assure to the shareholders a moderate return (four per cent) on capital actually paid in. This is a cumulative charge, and if not earned in any one year, is to be made good from the profits of the subsequent years. Provision is made for the disposition of earnings in excess of four per cent. In the first place, a contingent fund is to be created and maintained by contributions from earnings at an amount equal to one per cent of the capital stock. The fund, however, is not to exceed \$2,000,000, and is to be used to meet losses. It may not be treated as one of the assets of the Association in calculating the book value of its shares, nor can it be paid out to stockholders. In the event of the dissolution of the Association, it must be paid to the United States.

Viewing the earnings of the Association as in part monopoly profits, the bill limits the dividends to a maximum of five per cent. Whenever earnings exceed the amount needed for dividends of four per cent and the contingent fund requirements, one-half of the excess earnings must be paid into a surplus fund, one-fourth is to be paid to the government as a franchise tax, and one-fourth may be paid out to stockholders in additional dividends. When the stockholders are receiving five per cent in dividends, excess earnings are divided between the government and the surplus fund, until the latter reserve amounts to twenty per cent of the capital. Then all excess earnings go to the government. [P. 4; B. 19.]

The Association is expressly exempted from all state and local taxes, except those levied on real estate. [P. 7; B. 13.] The same exemption extends also to the branches of the bank, and to the local associations. But special franchise taxes are levied on earnings in excess of specified percentages of the capital, on an amount equal to the par value of two per cent government bonds taken over by the Association, on "uncovered" circulating notes when they exceed prescribed limits, and on the deficiency of the reserve. These taxes all have as their purpose something more than revenues for the government, and they are discussed under appropriate heads.

II. Organization of the Association

The largest part of the proposed legislation is devoted to the organization and government of the Association. Of the fifty-nine sections of the bill proposed by the Monetary Commission, twenty-three deal with these problems. The greatest care has been exercised in drawing up those provisions, in the hope that the opposition to a centralized banking system might be disarmed by the precautions taken to safeguard the Association against exploitation by selfish interests or misuse for political purposes.

The Association is to consist of a central organization with its seat in Washington, and branches located in various sections of the country. Upon its establishment, branches are to be opened in fifteen cities, distributed geographically as follows:

New England States	1
Eastern States	2
Southern States	4
Middle Western States	4
Western and Pacific States	4
Total.....	15

The states included in the divisions are specified in the bill, but it is left to the organization committee, entrusted with the formation of the Association, to select the cities in which the branch offices are to be located. As necessity arises, the number of branches may be increased, and the districts or sections belonging to these branches may be readjusted. The districts are to be apportioned with due regard to the convenient and customary course of business, and not necessarily along state lines. Disregard of political divisions will permit the adoption of districts characterized by more or less uniform needs and interests. In this way the work of the institution will be facilitated and made more effective. [P. 6; B. 5.]

The unit in the National Reserve Association is the local association. All banks belonging to the National Reserve Association are to be grouped into local associations, and every district is to be parcelled out among these associations. Every bank must join the local association of the territory in which it is located. No local association is to be constituted of fewer than ten banks, or of banks having an aggregate capital and surplus of less than \$5,000,000. The local associations are to be incorporated. As in the case of the districts, the original grouping of the associations is left to the organization committee, with the general direction that the customary course of business and the convenience of the banks are to be considered. The groupings may be later rearranged and added to by the Association. In their relation to the Association and to its branches, the local associations have about the same functions as the district and the central committees in the case of the German Reichsbank. In addition they have other duties, chief of which is to participate in the election of the majority of the directors of the Association and of its branches. [P. 5, 20; B. 6, 9.]

Each local association has its own board of directors and officers, elected yearly. One qualification for the directors is that they shall not be members of any legislative body. This requirement is implied in the general provisions of the bill, which prohibit members of state or federal legislatures from acting as directors of the Association, or of its subordinate organizations. The purpose is, of course, to keep the Association free from politics.

In the sections of the bill prescribing the manner of electing directors, great care has been taken to prevent any institution or individual from exerting an undue influence. Three-fifths of the directors are chosen by a ballot, in which every bank is entitled to but one vote, regardless of its capital and holding of shares of the Association. In the election of the other two-fifths of the directors, each bank is entitled to a number of votes proportioned to the number of shares of the Association owned by it. Precaution has been taken to prevent large banks or other interests from defeating the purpose of these restrictions by organizing a number of small banks, whose votes would enable them to control the local association.* The provision of the bill in this regard is sweeping and effective. Mr. Muhlemann† points out, in criticism, that such banks, taken together, are allowed but one vote in the election of the first group of three-fifths of the directors, and may not vote at all in the election of the second group or two-fifths of the directors. This restriction is too radical. He argues that at least one of the affiliated banks ought to be permitted to vote its own stock in the election of the second group of directors. Mr. Muhlemann's contention is thoroughly justified. The bill aims to

*For classification of the national banks according to their capital stock, see Appendix, Table VII.

†Maurice L. Muhlemann, "Categorical Discussion of Aldrich Plan." *The Banking Law Journal*, Vol. XXIX, No. 2; New York, February, 1912.

give to each bank an equal vote in the election of the majority or three-fifths of the directors, and this provision seeks to prevent the abuse of this privilege through the creation of dummy banks. The purpose is entirely served, if the restriction on the voting power of affiliated banks is applied only to the election of the group of directors, for whom all banks are alike entitled to cast but one vote. In the election of the other class of directors it is manifestly intended to make voting power proportional to stock ownership. The creation of subsidiary banks does not add to the voting strength of any bank or interest. There is, therefore, no reason for denying affiliated banks a vote in the election of the second group of directors. [P. 8, 27, 28; B. 7, 17.]

Every branch of the Association has its own board of directors. This consists of the manager of the branch, who is ex-officio member and chairman, and as many directors as may be determined by the by-laws of the branch. The number must not be less than twelve. The directors are chosen not directly by the representatives of the local associations, but indirectly through a system of electors. Under this system the vote for the majority of the directors is not proportional to the shares of stock of the National Reserve Association held by the banks in any local association. Each local association is required to elect a voting representative. In the election of one-half of the board of directors, each of the voting representatives is entitled to but one vote. In the election of one-third more, each representative casts as many votes as there are shares held by all banks belonging to this association. The directors elected in the manner here described, choose the remaining one-sixth of the directorate. These are to represent fairly "the agricultural, commercial, industrial and other interests of the district." The evident intention here is to prevent a too one-sided repre-

sensation of banking interests in the management of the branch. Accordingly, the bill makes provision that these directors "shall not be officers, nor, while serving, directors of banks, trust companies, insurance companies, or other financial institutions." To avoid sudden changes in policy, only one-third of the directors are to be elected each year, whereas the period of service is three years. Each branch may adopt its own by-laws, these to be subject to the approval of the National Reserve Association. [P. 9, 10, 11; B. 8.]

The active management of the business of the branch is placed in the hands of a branch manager and deputy manager. These must be residents of the district. They are appointed, and may be removed, by the governor of the National Reserve Association, subject to the approval of the executive committee of the Association and the directors of the branch. Their duties are to be prescribed by the National Reserve Association. [P. 25, 26; B. 16.]

Most interesting is the organization of the board of directors of the National Reserve Association, and the manner of electing the directors. In general the underlying idea here is the same as in the composition of the directorates of the branches. Here, too, the majority of directors are elected by the share holders, and again the manner of election is indirect; the balloting is in part by voting representatives. In the board of the National Association, the contingent representing outside interests is larger than in the case of the branches.

The bill provides for 46 directors, divided into four different classes:

(1) One group consists chiefly of government officials—the Secretary of the Treasury, the Secretary of Commerce and Labor, the Secretary of Agriculture and the Comptroller of the Currency. To these

there is added the governor of the Association, who is appointed by the President of the United States, and who, by virtue of his office, is chairman of the board, and two deputy governors elected by the board of directors. These seven are ex-officio members of the board. In the original plan the Secretary of Agriculture was not included. In the bill, he too is given a place on the board, so as to make the Association representative of all interests, agricultural as well as commercial.

The placing of four representatives of the government on the board is evidently in accordance with the example of the German Reichsbank Act,* which provides for the appointment of the president and the executive officers by the emperor. Through these representatives, the government is enabled to express its views and to lay its policies before the Association. The delegation of the government on the board is, however, too small to control the action of the Association.

The other 39 members are divided into three classes:

(2) One group of 15 directors is made up of the representatives of the branches, each branch electing one.

(3) Another group of 15 directors is constituted, as in the directorates of the branches, of the representatives of agriculture, trade and other interests. This group of directors is also elected by the branches, one being delegated by the board of each branch.

If the number of branches should be increased, these two classes of directors will be added to proportionately. Only in this way can the number of

*Sections 25-27, German Bank Act of March 14th, 1875.

directors be augmented without further authorization by Congress.

(4) Nine more directors are to be chosen by voting representatives of the branches. In the election of these nine, each voting representative is entitled to one vote for each share of stock of the National Association owned by the banks belonging to the branch for which he acts. In the choice of these directors alone is the voting power based directly on and in proportion to stock ownership.

The directors are to be elected for a three-year term, one-third to be renewed annually. This provision is the same as in the case of the branches. A new feature here is the clause intended to prevent any section of the country, or any group of interests, from exerting excessive influence in the Association. It is provided that, of the nine directors elected on the basis of stock ownership, not more than one may come from the same district. Furthermore, it is necessary that every one of the directors, except those representing the government, shall be residents of the districts from which they are elected. [P. 14-19; B. 9, 10.]

In framing this provision, the authors have evidently overlooked the fact that it is impossible to apply it to the nine directors elected by the voting representatives of the branches. Fifteen branches are entitled to vote, but only nine directors are to be chosen. At least six of the voting representatives of the branches must therefore vote for a director who is not resident of their respective districts. If these branch electors are forbidden to do so, six of them must refrain from voting entirely—a situation which was certainly not intended, and which can not well be justified. The intention of the bill on this point should be made clear and explicit.

The safeguards thrown around the election of the direc-

tors are, on the whole, proper and adequate for the purpose. Advocates of the plan justly lay great stress on these features. They claim that the restrictions are well calculated to secure a fair representation of all interests of the country, and that they make it impossible for any combination of interests to gain control of the Association. Every district, regardless of its banking resources, is assured of at least two representatives on the board, and no district, no matter how many shares its banks may own, can have more than three representatives. Thus, as the Monetary Commission points out in its report,* the State of New York could have no more than three directors, or 8% of the total number on the board, although New York City alone has more than 26% of the entire banking resources of the United States. The Eastern States taken as a whole could have no more than six representatives, in spite of the fact that they possess 29% of the banking capital and 41% of the resources of all the banks of the country. On the other hand, the Middle West, with 24% of the Nation's banking resources, would have 31% of the vote in the Association, and the South, with 11% of the banking resources, would have 23% of the representation on the board. According to the calculation of the Monetary Commission, "no combination of Eastern and Middle West [states], with other interests could be made, which did not include more than 80% of the banking power of the country." Such a combination for the purpose of controlling the Association is scarcely probable.†

Similar precautions have been taken in the organization of the executive committee of the directorate. It is made to consist of nine members. Five are chosen by the board of directors: of these no more than one may come from the same district. The other four are ex-officio members. They are

*Page 33.

†See Appendix, Table V.

the Comptroller of the Currency, the governor of the Association, who is ex-officio chairman of the committee, and the two deputy governors. The executive committee is with few exceptions entrusted with all powers of the board of directors. The chief exception is the right to propose the governor for appointment, and to elect and to remove the deputy governors. [P. 21, 22; B. 14.] The only other committee specifically mentioned in the bill is the "board of examination." Its functions are to examine into the condition and business of the Association and its branches, and to publish a report at least once a year. The organization of this committee is not prescribed in full detail. One provision is that members of the executive committee can not serve. The Secretary of the Treasury is made the ex-officio chairman of the examination board. [P. 23; B. 15.] On these two most important committees, it will be observed, the government is given a certain amount of official representation. It is thus enabled to exert a limited influence on the administration of the Association.

As in the case of the branches, the board of directors shares its executive functions with a business manager—the governor of the Association. The governor is appointed by the President of the United States from a list of at least three names, submitted by the directors. His term of office is ten years, but he is subject to removal earlier for cause by a two-third vote of the board. The Aldrich plan originally contemplated a life term. Such a measure would have made the position of the governor much stronger than it is under the bill. In a central bank of issue, it is undoubtedly desirable that the head should enjoy all possible independence. There is, indeed, danger that he might allow himself to be influenced improperly, but he could not well misuse his position, without subjecting himself to removal for

cause. There are, nevertheless, strong grounds for opposing life tenure, for it is often desirable to infuse new blood into the organization. The plan of a long term of office, as proposed by the Commission, seems therefore best; it is moreover in keeping with the democratic sentiment which is in general opposed to life tenure in office.

Besides the governor, the executive officers specifically provided for are two deputy governors and a secretary. The deputy governors, chosen by the board of directors, are to hold office for seven years, but their terms of office are not to be for the same period. Accordingly, at the organization of the Association, one of the deputy governors is to be elected for a period of only four years. The board of directors is authorized to appoint other officers, and the manner of choosing these and also the secretary is left to the Association, to be provided for in its by-laws. [P. 24; B. 10.]

The system here described is for the permanent organization of the Association. Provision is made also for a temporary committee, to effect the establishment of the Association. This organization committee consists of the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency—the officers who represent the government on the board of the Association. Within sixty days after the passage of the proposed legislation, the committee is required to open subscriptions to the capital stock of the Association. When subscriptions amount to \$200,000,000, the committee must proceed to select cities for the location of the branches of the Association, to divide the country into districts corresponding with the branches to be established, and to group the banks in each district into local associations. On the completion of the preliminary organization by the

committee, it becomes the duty of the banks to establish the permanent organization through these channels. [B. 4, 5, 6.]

When the National Association has been duly organized, its board of directors must call for the payment of fifty per cent of the subscriptions. As soon as \$100,000,000 has been paid in, the directors are to file a certificate to this effect with the Secretary of State, and may commence business. [B. 1, 6, 11.]

III. Functions of the National Reserve Association

The underlying idea of the proposed legislation is that the Association shall serve merely as the agent of the banks forming it. In keeping with this fundamental thought, the Association's field of operation is limited, so that it will not come into competition with the banks. It is accordingly, permitted to do business in this country only with the "member banks" and with the government. As agent for the banks, it is obliged to treat them all alike, and to extend the same rights and privileges uniformly to all the institutions belonging to the Association. [P. 34; B. 22.]

A distinction is made in the activities in which the Association may engage within the country, and those open to it abroad. In the United States, outside of the transactions with the constituent banks and the government, it may carry on only such operations as are necessary for the maintenance of the gold reserve. In foreign countries it is also limited to transactions essential to the proper discharge of the same functions. However, in its foreign business the Association is allowed more latitude. It may open accounts with foreign banks, establish agencies abroad, and purchase and sell foreign bills of exchange.

1. Reorganization of the Bank Note System

Among the most important features in the proposed reform for our banking system are the functions assigned to the Association in the issue of bank notes. The plan contemplates ultimately the abandonment of the issue of notes by the national banks. In place of the rigid bank currency based on government bonds, shall be instituted an elastic system adapted to the needs of business and centralized in the Association. The following quotation from the bill expresses the basic purpose of the measure; it is declared to be "the policy of the United States to retire as rapidly as possible, consistent with the public interest, bond secured circulation, and to substitute therefor notes of the National Reserve Association." [P. 66; B. 49.]

The centralization of the note issue is not to be effected by compelling the banks to abandon their existing privileges. No pressure is applied directly for this purpose. The banks are, however, not to be permitted to extend their present circulation. Moreover, as they retire all or any part of their outstanding notes, they lose the right to reissue them. [P. 65; B. 48.]

A question of prime importance in the proposed reforms is the extent to which banks will continue to exercise their present circulation privilege. The answer is in a great measure dependent on the provisions of the plan, which will make it possible for the banks to dispose of the two per cent bonds. The greater part of these securities outstanding is in the hands of the banks, and they hold them because of the circulation privilege which they carry.* This privilege attaches an artificial value to those government bonds to which it applies—particularly the two per cents. Consequently

*For debt of the United States see Appendix, Table II.

they sell at a price for which they could not be disposed of to investors. If the circulation privilege were to be taken away, the price would fall and a great loss be incurred by the banks. Provision is accordingly made in the plan, whereby national banks may, without incurring loss, dispose of their holdings of two per cent bonds. The Association is obligated to take them over at par. It thus assumes the loss which would devolve on the banks if the two per cent bonds were deprived of the circulating privilege. On taking over the two per cent bonds, the Association assumes responsibility for redeeming the notes secured by them. [P. 66; B. 49.] It is at the same time proposed to repeal the Act of May 30, 1908, which under conditions permitted the issue of bank notes on depositing with the United States Treasury securities other than government bonds. [P. 67; B. 47.]

The note issue would thus gradually become restricted to the Association. On taking over the two per cent bonds from the banks, they would cease to be, as they now are, the sole security for circulating notes. The Association itself is authorized to issue its notes on the security of lawful money, commercial paper, and in part also government bonds. The latter can not be used as security for more than two-thirds of the amount of its outstanding notes. To the extent that the Association relieves the national banks of their two per cent bonds, the bank note currency of the United States is advanced towards a new system of circulating notes, freed from sole dependence on government bonds.

The plan, however, goes further and does not contemplate that bonds should permanently be used to any extent as a basis for the notes of the Association. The securities taken over from the national banks are ultimately to be retired, and therewith the use of bonds in connection with the note issue will be entirely done away with.

The bonds which the Association is obligated to take over from the banks, would cease to be marketable at present prices as soon as their circulation privilege is taken away. Provision is accordingly made to enable the Association ultimately to convert these securities into cash. The Secretary of the Treasury is directed to exchange these two per cent bonds for three per cent bonds, carrying no circulation privilege. These bonds are payable fifty years from date, and the Association is required to hold them during its corporate existence. The government, however, reserves the right to redeem them at par before maturity, or to purchase them at par for the postal savings banks or for other purposes. Moreover, five years after organization, the Secretary of the Treasury is authorized to permit the Association to sell as much as \$50,000,000 of these bonds in any year. [P. 73, 75; B. 55.] This limitation has evidently been inserted in order to prevent these bonds from being thrown on the market to an extent that would depress their price and injure the credit of the government.

The plan implies the intention of the government to redeem the two per cent bonds, and to retire them through this indirect method of first exchanging them for bonds bearing a rate of interest which would probably make them marketable at par to investors. Ultimately, the Association is permitted to dispose of its three per cent bonds as well, the government repurchasing them, or permitting the Association to dispose of them gradually in the market. The Association is not *compelled* to exchange its two per cent bonds for the three per cent bonds, but, as we shall see below, the inducement held out in the higher rate of interest is apparently sufficient to lead the Association to adopt this policy.

The exchange of two per cent bonds for three per cent bonds would mean an increase in the rate of interest on

that part of the funded debt of the United States, which is now held by the banks, and which under the plan would be transferred to the Association. To obviate such a result, the Association is required to pay the government an annual franchise tax equal to one and one-half per cent of the amount of bonds taken over from the national banks. This corresponds to the tax which the national banks now pay for their circulation privilege. The franchise tax is payable on the amount of bonds regardless of their ultimate disposition through exchange for three per cent bonds, and the sale or redemption of the latter. One purpose of the provision is fiscal. At present the government receives from the national banks a tax of one-half per cent on all bonds used to secure their circulating notes. As it is proposed to refund these bonds through exchange for three per cents, a tax of one and one-half per cent will leave the government in the same position as it is now with its two per cent bonds outstanding. In the words of the Commission: "The effect of these provisions taken together is that the United States will be able to fund seven-ninths of the national debt at a net interest charge of one and one-half per cent." [P. 74, 75; B. 56.]

From the point of view of banking theory, this use of a central bank of issue to further the fiscal interests of the government, is open to serious objections.* From a practical standpoint the plan of the Commission is fully justified. The conversion of the two per cent bonds into three per cent bonds, without the privilege of circulation, is nec-

*Another objection to the franchise tax is that the Association would have to pay it, no matter whether its operation yielded a profit or resulted in loss. The principle enunciated by the Commission is that "all profits which may arise from note issues will be paid into the Treasury of the United States." [*Report*, page 18.] It is not consistent with such a principle that the Association should be called upon to pay a tax if the business yields no profit.

essary in order to save the present owners from the loss which would result through the depreciation of the two per cent bonds, if they could no longer be used as security for the circulation of bank notes. The imposition of the tax of one and one-half per cent is equally necessary, else the federal government would be burdened with a one hundred per cent increase in the interest charge on a very large part of its outstanding indebtedness. Without these two measures it would be impossible to introduce in the United States a bank note currency free from dependence on government bonds. While the tax to be imposed appears at first sight to be a purely fiscal measure, it becomes evident on closer examination that it has an important purpose in the plan of banking reform. It is a necessary measure, if the way is to be paved for the establishment of an elastic system of bank currency.

The purpose of the Association is not merely to take over the note circulation of the national banks, but to introduce elasticity into the issue of notes and adapt the circulation to the ever-changing needs of business. No absolute limit is therefore imposed on the amount of notes which the Association may issue. But overexpansion of the note circulation is guarded against in several ways. In the first place, a progressive tax is imposed on outstanding notes not covered by reserves of cash or lawful money, whenever the amount of such notes exceeds prescribed limits. In the second place, an indirect limitation is imposed through the requirement that the notes issued be based on specified forms of collateral in fixed proportions. In the third place, the Association is required to keep reserves against its notes, together with its other demand liabilities, and it is taxed on deficiencies in such reserves. Whenever the cash reserve falls below one-third of the outstanding notes, no further notes may be

issued. The plan here adopted combines the best features of the German and Italian systems. It allows, untaxed, an issue of notes not covered by an equivalent reserve of cash or lawful money, amounting to \$900,000,000. Whenever their amount exceeds \$900,000,000, the surplus is taxable at the rate of one and one-half per cent; when the total rises above \$1,200,000,000, the excess amount is taxed at five per cent. [P. 69; B. 51.]

The requirements applying to the security for the notes, namely, that the circulation should be safeguarded by definite forms of collateral in fixed proportions, is founded on the principle adopted from German bank legislation.* Thus the Association may not issue notes, unless these are based at least to the extent of one-third on cash (i.e. gold coin or bullion, or other lawful money held by the Association). For the other two-thirds, the security must be first class notes and bills arising out of commercial transactions or bonds of the United States. [P. 68; B. 50.]

It was urged before the Commission that gold should be the only recognized form of cash reserves. This proposal was not adopted. As the Commission states,† under the act of March 14, 1900, the gold standard was finally established, and the other currency, then declared to be legal tender, was by that measure made practically equal to gold. There is, therefore, no occasion for departing from the provisions of that act. Suspension of payment in gold by the Association, which might endanger the gold standard, is sufficiently guarded against by imposing on the Association the duty of maintaining its notes at all times at a parity with gold. [Cf. B. 52.]

The Association is, furthermore, required to maintain prescribed cash reserves to cover its outstanding note issues

*Section 17, German Bank Act of March 14th, 1875.

†Report, page 19.

together with its other liabilities. In general it is intended that such reserves should be equal to fifty per cent of the Association's liabilities. Whenever these reserves fall below fifty per cent, an increasing tax is levied at a rate of one and one-half per cent for every two and one-half per cent of deficiency in the reserves. It is further prescribed that when the cash reserve falls below one-third of the outstanding notes, no additional notes may be issued. [P. 55; B. 41.]

There are certain obscurities in the regulations pertaining to the security for the outstanding notes of the Association. For example, it is not clear whether the requirement in the bill means that outstanding notes must *at all times* be covered by reserves of cash or legal tender to the extent of at least one-third of their face value, or whether this provision refers only to the time when such notes are issued, and that the reserve may subsequently be allowed to fall below the minimum.

Two sections of the bill bear on this point, 50 and 41. The first-named deals expressly with the security for notes issued. It reads as follows: "All note issues of the National Reserve Association shall *at all times* be covered by legal tender reserves to the extent required by section 41 of this act and by notes or bills of exchange arising out of commercial transactions as hereinbefore defined, or obligations of the United States." Section 41 gives two standards for the reserves to be kept. One applies in common to notes and deposits, the other applies to notes only and imposes the same requirement (one-third of the outstanding circulation) as is found in section 68 of the revised plan. It reads: "All demand liabilities, including deposits and circulating notes, of the National Reserve Association, shall be covered to the extent of fifty per cent by a reserve of gold (in-

cluding foreign gold coin and gold bullion) or other money of the United States which the national banks are now authorized to hold as a part of their legal reserves. Provided, that whenever and so long as such reserve shall fall and remain below fifty per cent the National Reserve Association shall pay a special tax upon the deficiency of the reserve at a rate increasing in proportion to such deficiency as follows: For each two and one-half per cent or fraction thereof that the reserve falls below fifty per cent, a tax shall be levied at the rate of one and one-half per cent per annum: Provided further, That no additional circulating notes shall be issued whenever and so long as the amount of such reserve falls *below* thirty-three and one-third per cent of its outstanding notes."

The section defining the reserves to be held against both outstanding notes and deposits can be interpreted in only one way. The aim of the legislation is clear. In general, the cash reserve for *demand liabilities* of the Association—deposits as well as notes—should be at least 50%. This requirement is, however, not absolute. The enforcement of it is not made rigid, and the intention is to influence its observance through the imposition of a graduated tax on the deficiency of the required reserve, the rate of the tax increasing as the reserves diminish. The provisions applying specifically to the reserves covering the note issue are not so clear. From section 50 it would appear that the intent is to keep *at all times* a minimum cash reserve equal to one-third of the outstanding notes. Does this mean that the Association is prohibited from carrying out any transaction, no matter how urgent, if to do so would reduce the cash reserve below one-third of the face value of the outstanding notes? Such a view is not consistent with the concluding clause of section 41, which contemplates the possibility of the reserve falling below the above named minimum. This seems

to be the sense of the words: "No additional notes should be issued, whenever and so long as the amount of such reserve falls *below* thirty-three and one-third per cent of the outstanding notes." This proviso would evidently mean that no additional notes may be emitted, but the Association may continue its operations, even though they involved the reduction of the cash reserve below the minimum here specified. Thus the Association might redeem notes or repay deposits in cash, or make cash loans. This interpretation of section 41 would not only contradict the wording of section 50, but would also be inconsistent with the sense of section 52. According to the latter section, the circulating notes of the Association are made a first lien on the assets of the Association. This intent would be violated, if the Association were permitted to reduce its cash reserves below the specified minimum, and to pay out its funds in loans or in the repayment of deposits, or in other transactions which would impair the security of these "preferred" notes. The protection to the note holders held out by section 52 would become illusory.

It is indeed true that the reduction of the reserve below the one-third minimum is a remote contingency. The penalty imposed through the progressive tax becomes operative whenever the cash reserve falls below fifty per cent of the combined notes and deposits, and would practically make it impossible for the reserves to be depleted to an amount below one-third of the outstanding notes. It is nevertheless desirable that the law on this point should be made clear and explicit. If it is indeed intended to permit the Association to pay out money, even though the cash reserve has fallen below one-third of the amount of the outstanding notes, then section 50 should be modified and the words "at all times" omitted. In fact, the entire section would be superfluous, for the clause to the effect that, outside of

lawful money, only bills and government obligation can be used to secure circulating notes, might well be transferred to another section, perhaps to section 41. While these changes would make the meaning clearer, the right to pay out cash, under the circumstances, would still be inconsistent with the idea that the notes represent a preferred claim on the Association's assets.

The plan contemplates that ultimately commercial paper and cash should be the basis for the issue of circulating notes. Through the use of commercial paper as security for notes elasticity will be introduced in the note system, and in the monetary system as a whole. The importance of commercial paper for the note circulation will increase in proportion as the existing two per cent bonds are retired. The provisions dealing with the transactions of the Association in commercial paper are discussed at length under the head of the discount activities of the Association. The chief points to be noted here are as follows: (1) The bills acquired by the Association and used as basis for its note issue must arise out of commercial transactions; finance bills can be discounted only in exceptional cases. (2) The bills acquired by the Association can not run for more than four months, and the great bulk will be paper having less than twenty-eight days to run. These provisions mean that the note circulation, to the extent it is based on commercial paper, will be responsive to the needs of business, and expand and contract with the demands of trade and industry.

The plan permits the obligations of the United States to be used along with commercial bills to cover notes outstanding. This provision is in conflict with the purpose of the legislation, which is to modernize the note system, and free it from dependence on the government debt. The notes of

the Association based on government bonds would not be so very different from the present national bank notes. This feature is retained, because it is not feasible to depart too radically from the existing system, so long as there are in existence the present two per cent bonds, for which there is no other use. It is, of course, hoped that these bonds will be disposed of by exchange for three per cent securities carrying no circulation privilege. Even these are gradually to be eliminated from the banking system by sale or by redemption.

From the point of view of security for the holder, the notes to be issued by the Association would be superior to those of the European central banks. The latter do not, like the notes of the Association, constitute a first lien on the assets of those institutions. Furthermore, the regulations governing the redemption of the Association's notes are more stringent; they require immediate exchange for lawful money, not only at the head office of the Association, but also at all of its branches. [P. 70; B. 52.]

The Association's notes are legal tender only to a limited extent and can not be used in payment to the same degree as the notes of the European banks. They are legal tender in all payments to the federal government, and in the settlement of all obligations by the United States, except those which specifically by their terms call for payment in gold. They are further legal tender in transactions between the banks, and in payments of obligations to the banks by individuals. [P. 71; B. 53.] Banks belonging to the Association may, moreover, treat the notes as part of their legal cash reserves. [P. 51; B. 39.] On the other hand, in transactions between individuals they are not legal tender, and their acceptance in payment of obligations is purely voluntary.

2. Protection of the Gold Reserve

In operations intended to maintain the gold reserve or to augment it, the Association has greater freedom than in any other branch of its business: This part of its activities is not restricted to transactions with the members of the Association or with the government.

The functions for the maintenance of the gold reserve are similar to those of European central banks. Important is the right to deal in gold in bullion or coin. Furthermore, special provisions permit the Association to extend its dealings to European countries, and to make loans secured by collateral of gold. It is authorized to borrow gold in bullion or coin, and to give security for such loans. [P. 44; B. 34.] For this purpose it is permitted to pledge its holdings of government bonds. Whether this provision refers to the three per cent bonds to be given in exchange for the present two per cent securities, is not clear. The provisions in section 75 of the revised form of the plan [B. 55] prohibit the Association from disposing of the three per cent bonds without the special authorization of the Secretary of the Treasury. Securities which are not negotiable can not well be used as collateral for loans, for the prime purpose of collateral is to serve as a security to be disposed of, if the borrower fails to pay. If this provision refers also to the three per cent bonds, the pledgee would have to be given the right to sell these bonds under certain conditions. Such a provision would open the way for evading the prohibition on the sale of these bonds. This is, of course, only a possibility, and we may well question the probability of such a situation arising.

For the transactions of the Association in gold, the law fixes no minimum price at which the Association must give

its notes in exchange for bullion. These regulations governing the Association are more flexible than those applying to the Bank of England and the Reichsbank of Germany.

To facilitate gold transactions, the Association is expressly authorized to deal in foreign bills of exchange. The law distinguishes between transactions abroad and those in this country. Foreign bills of exchange can be bought in the United States only from the banks belonging to the Association. This regulation applies also to domestic bills. Abroad, however, the Association enjoys a free hand. It is permitted to open accounts with European banks, and to institute agencies in order to facilitate its business in foreign bills. But whether purchased here or abroad, bills must be based on commercial transactions. Furthermore, they must bear at least two good signatures and have no more than ninety days to run. [P. 45, 46; B. 35, 36.]

Finally, to further facilitate the work of the Association, it is authorized to buy and sell bonds and short time obligations of the United States and of foreign countries, and also of the federal states and American colonies. Short time obligations are defined as running not longer than one year. The bill does not discuss in detail the kind of federal securities referred to here. We may assume that bonds carrying the circulation privilege are excluded from the scope of its business, and also trade in the three per cent bonds, into which the present two per cent bonds are to be converted. This is clear from the special restrictions imposed on the sale of the three per cent bonds. The purpose of allowing the Association to deal in government securities is obvious. Bond holdings will enable the Association to draw gold readily from abroad through the sale of securities in other countries. Doubtless another motive in confer-

ring the privilege of buying and selling bonds upon the Association is the desire to create an additional market for the absorption of domestic loans. [P. 35, 43; B. 24, 33.]

3. Deposits and Domestic Exchange

In addition to its activities in the issue of circulating notes, the Association is to serve as a depository for the United States. It will doubtless secure very considerable funds also from ordinary deposits by subscribing banks. In keeping with the regulations or practice of European central banks, the Association is expressly prohibited from paying interest on deposits. [P. 37; B. 25.]

The Association is to act as treasurer for the United States. All the revenues of the government are to be deposited with the Association and to be disbursed by it. The only exception here made is trust funds; these are to be left in the hands of the government, as heretofore. The transfer of the work of the treasury to the Association will mean a large saving to the government. To the country as a whole it will mean vastly more. It will eliminate once for all the disturbances to business incident to the present policy of an independent treasury for the government, which involves the withdrawal of funds from the country regardless of conditions or the needs of business.* Using as a basis the large working balance now kept by the government, Mr. Forgan† has estimated that the Association would take over from the government deposits to the amount of \$100,000,000. [P. 1, 35, 36; B. 23, 24.]

*A. Piatt Andrew, formerly Assistant Secretary of the Treasury. "The Relation of the N. R. A. to the Government." Address delivered before the American Bankers' Association at New Orleans, Nov. 21, 1911.

†"The Mobilization and Control of the Reserves of the Country." Cited p. 15.

Next to the government, the banks belonging to the Association will be the source of deposits. These will find it greatly to their interest to keep large sums with the Association. Forgan estimates that the Association will have at the outset about \$500,000,000 in deposits from banks. One advantage is in discounting bills. In general this privilege is open only to banks carrying deposits with the Association. Moreover, deposits with the Association may be treated by the banks as part of their cash reserve, required by law. [P. 35, 51; B. 24, 39.]

Another source of funds for the Association will be its domestic exchange operations or transfer of deposits. This is a new feature in the American banking system. Under the provisions of the bill, one of the duties of the Association and of the branches is to transfer, upon request of a bank, any part of its deposit to the credit of other banks dealing with the Association. This may be effected by mail, telegraph, or otherwise. The charge for the service is left to the manager of the branch where the transaction originates.

In this system of domestic exchange, the institutions primarily interested are the head-office of the Association, its branches, and the local associations. The "giro" business, as it is known in Germany, will be carried on first only between the Association and its 15 branches. The service is not to be rendered free of charge as in the German system. It is therefore not likely to assume here the importance that the "giro" business has in Germany in the settlement of obligations.* [P. 47; B. 37.]

4. Discount Activities at Home

The proposed legislation contains a number of general regulations applying to the domestic discount activities of the Association. These are scattered through the bill. The

*Compare pp. 136 and 137.

most important provision is that requiring a uniform rate of discount for all sections of the country. This rate must be public. [P. 41; B. 30.] A public and uniform rate of discount applying to the entire country is made a fundamental principle for monetary reform. This is in marked contrast with the existing system of decentralization in the issue of bank notes. The objections that may justly be made against this requirement are discussed later (cf. pp. 132 and 133).

The general regulations governing the discount activities of the Association prescribe that discounts must be applied for at the branch in the district where the bank is located, [B. 29] and that only notes and bills arising out of commercial transactions may be discounted. [P. 38; B. 26.] The paper referred to embraces bills and drafts having their origin in the affairs of agriculture, industry and trade. Bills arising from sale of securities, bonds and stocks, can not be discounted. This regulation would exclude finance bills. The maximum maturity of paper which may be discounted is fixed at no more than four months. [P. 39; B. 27.]

There is no general requirement with regard to the number of signatures that such paper must bear. The only prescription is that the last signature should be that of a bank belonging to the Association, and that in some cases the paper should have the endorsement of a local association. This requirement is, of course, part of the general feature of the measure, which restricts the Association to transactions with the subscribing banks.

Another restriction on its discount activities has been noted above, namely, that the Association may purchase bills only from such banks as carry deposits with it. This requirement, however, is not specifically mentioned in connection with foreign bills of exchange, or with prime discounts, but it presumably applies to these too. [P. 38; B. 26.]

Apparently this is the meaning of the first clause in the provision relating to discounts. It reads as follows: "The National Reserve Association may through a branch rediscount for and with the endorsement of *any bank having a deposit with it*, notes and bills of exchange arising out of commercial transactions."

For purposes of discount a distinction is made between bills guaranteed by the local associations and those not so guaranteed. The latter class of bills is again divided into three classes: (1) Bills falling due in 28 days; (2) Prime bills; (3) Foreign bills of exchange.

(1) *Bills falling due in 28 days, or less, and drawn at least 30 days before the date of rediscount.* Presumably this class of paper will constitute the great bulk of the bills handed in by the banks for discount. Such paper is peculiarly well suited for rediscounting whenever a bank needs cash for immediate or temporary purposes. Overexpansion of discounts is guarded against by a provision forbidding the Association to discount for any bank an amount of bills that is in excess of the bank's capital. A further safeguard is provided by prohibiting the Association from discounting for any institutions bills bearing the signature of the same person or company, which amount to more than ten per cent of the capital and surplus of the bank. This provision has the further merit of inducing the individual banks to pursue a sound discount policy. [P. 38; B. 26.]

(2) *Prime bills* are defined as having no more than 90 days to run and bearing the acceptance of banks or acceptors of unquestioned financial responsibility. The bank endorsing such bills must not be the one accepting them. Such paper may be discounted only whenever the conditions of the Association and the general financial situation warrant. Bills of this character represent the best form of com-

mercial paper, and the question may be raised whether it would not be desirable to authorize the discount of such securities below the official rate. This right might be limited, and the Association permitted to discount below the official rate only when the latter did not exceed a specified rate. Unless such a provision is made part of the law, there is little probability that prime bills will be offered for discount to the Association, except perhaps for collection. [P. 42; B. 32.]

(3) *Foreign bills of exchange.* The Association is further authorized to buy bills of exchange, including checks and notes, drawn on England, France, Germany and such other countries as the board of directors may determine. These must bear at least two signatures of responsible parties and have not more than 90 days to run. [P. 45; B. 35.]

The paper for which a guarantee is required from the local association is of two kinds: (1) *Direct obligations of a bank*; (2) *Notes that have more than 28 days to run*, but not more than four months.

(1) Acceptances of a bank may be discounted by the Association for the accepting bank only in exceptional cases, when in the opinion of the governor of the National Reserve Association the public interests so require. His opinion must be concurred in by the executive committee and must have the definite approval of the Secretary of the Treasury. In other words, it applies only to cases of emergency. The discount of the direct obligations of a bank is subject also to other restrictions. Not only must such obligations bear the endorsement of the local association, but before giving it, the local associations, as the representatives of the National Association, are required to demand security. In no event may the guaranty be for an amount in excess of three-fourths of the actual value of the security. Under these provisions,

the Association is permitted to discount the direct obligations of any bank, only in extreme cases and under special precautions. This feature of the plan is highly commendable.

(2) The guaranty of notes having more than 28 days to run, but not more than four months, is not subject to such stringent restriction. The local association may demand security or not, as it sees fit.

Otherwise the limitations on the right of the local associations to guarantee such paper is covered by general provisions applying equally to such paper and to the direct obligations of a bank. The amount which the local association may guarantee is limited to the combined capital and surplus of the banks constituting the local association. The latter regulation sets an absolute limit to the rediscounts of this class that may be asked of the National Association. In the event that all the banks joined the Association, the amount of such rediscounts would at its maximum be \$3,000,000,000. This is, of course, assuming that the Association would be in a position to discount so large a volume of paper. The guaranty of paper here referred to is for the local associations second in importance only to their function in the election of directors of the National Association.

Banks having their paper guaranteed are required to pay a commission. The added cost under this provision will doubtless prove effective in reducing to a minimum the instances in which banks will apply for the endorsement of the local association, and the volume of paper offered for discount. The profits arising from the endorsement fee, and likewise the losses incurred through guaranty, are to be divided among the banks of a local association on the basis of the shares in the National Reserve Association which they hold, rather than in accordance with the amount of paper guaranteed for them. Naturally it will be to the advantage

of each bank to submit the least possible amount of bills and notes for endorsement by the local association. Bills requiring guaranty by the local association will be offered to the Association for rediscount only in emergencies. As we shall have occasion to see later, this is one of the worst defects of the entire system as proposed. On the other hand, we must not lose sight of the purpose here kept in mind, namely, to prevent undue pressure on the discount facilities of the Association. [P. 29, 30, 39, 40; B. 20, 27, 28.]

5. The Ownership of Real Estate

Transactions in real estate are obviously not in accordance with the purposes of the Association. Real estate can not easily be converted into cash, and it is often subject to speculative influences and wide fluctuations in value. For a note bank to tie up any considerable part of its funds in real estate would be to act contrary to its essential nature and purpose. This has been universally recognized in Europe, and it is also taken account of in the bill. The Association is permitted to own permanently only such real estate as it needs for the transaction of business at the central office and at the branches—in other words, for office purposes. Specific provisions define the real estate that the association may hold for other than office purposes in the terms of the National Bank Act, as follows:

“Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

“Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.

“Such as it shall purchase at sales under judgments, decrees, or mortgages held by said association, or shall purchase to secure debts due to it.”

The dangers which might result from the acquisition of

real estate are, to a very considerable extent, reduced by forbidding the Association to hold real estate not intended for office purposes longer than five years. [B. 38. In the "Plan" there are no corresponding provisions.]

IV. Duties of the National Reserve Association

The importance of publicity in the affairs of the Association is not overlooked. Like all the great European note banks, it is required to submit weekly statements of its condition to the Comptroller of the Currency. These must be made public. No definite schedule is fixed by the bill for these weekly statements. We may, however, feel sure that the principle of publicity will be carried out very fully, and that the public will be given detailed statistics for the various activities of the Association. Besides weekly statements, the Association is obligated to make detailed reports to the Comptroller of the Currency five times a year, in the same way as the national banks. The form of report is not prescribed, but it is probable that the existing regulations applying to the national banks will be adapted to fit the business of the Association.

The Association must keep at its head office an exact list of the names of the banks belonging to it, and of the amount of shares held by each of them. This list will be open to every member, and once a year (on the first Monday in July) a copy must be transmitted to the Comptroller of the Currency. The Association must inform the Comptroller promptly of every increase in its capital stock due to the entrance of new members into the Association, or decrease occasioned by the withdrawal of member-banks. He will thus always be in possession of an up-to-date register of members. [P. 57; B. 43.]

Under the plan, the Association is required, in the first place to maintain special reserves to protect its outstanding note issue [P. 68; B. 50, 41]. In addition, however, the proposed legislation follows the regulations governing the national banks, and requires cash reserves to secure also deposits. All current obligations, deposits as well as notes, must be covered to the extent of fifty per cent by a reserve of gold and other lawful money. Fortunately this requirement has been made thoroughly elastic. The cash reserve may be permitted to fall below fifty per cent, but if this happens, the Association is subject to a graduated tax for the deficiency in the reserve. A tax of one and one-half per cent per annum is levied for a deficiency in the reserve up to two and one-half per cent, and this tax is increased by one and one-half per cent for every additional deficiency of two and one half per cent or fraction thereof. [P. 55; B. 41.]

In calculating the amount of current obligations for which the Association must maintain cash reserves, it may deduct one-half of the bonds taken over from the national banks for the purpose of acquiring their rights to issue circulating notes. This impairs the character of the security for the current obligations very considerably. However, if the two per cent bonds are ultimately retired, as the plan contemplates, this objection will disappear. [P. 56; B. 42.]

V. Activities of Banks Belonging to the Association

No new limitations are imposed on the activities of the national banks joining the Association. On the contrary, they are given greater freedom of action. They are granted the right to make acceptances, in order to facilitate the organization of a general market for commercial paper. In other respects too, their position is made more favorable, so that national banks will find themselves at less disadvantage, as

compared with state institutions. Speaking on this point at the Bankers' Convention in New Orleans Senator Aldrich* declared that it was not fair to the national banks, that state banks and trust companies should enjoy more favorable terms, and that it was only just that the three classes of institutions should share the same privileges and obligations.

Nothing is said in the bill about the activities of state banks and trust companies. These are, of course, subject to the legislation of the different states. They are affected only indirectly by the proposed plan, *i. e.*, if joining the Association. Such institutions must then submit to the same conditions as are imposed on the national banks with reference to their reserves, statements, and reports. The capital requirements for trust companies differ from those for national banks and state banks. Further details are discussed under the proper heads. The bill thus tends to make conditions uniform for national banks, state banks, and trust companies. It can not extend the rights and privileges of those state institutions beyond the limitations imposed upon them by the states. From current discussion, however, it is believed probable that the states are willing to enlarge the powers of their banks and trust companies to conform to those granted the national banks under the plan.

The proposed legislation creates more favorable conditions for negotiating commercial paper. National banks will benefit most by this privilege which is conferred on them regardless of membership in the Association. They are given the right to accept bills originating in commercial transactions, properly secured, and having no more than four months to run. The right of making acceptances is, however, subject to two limitations. Banks may not accept notes in excess of one-half of their capital and surplus.

*"The Proposed Monetary Plan." Address delivered Nov. 21, 1911.

The second restriction is modelled on section 52 of the National Bank Act. It forbids a bank to grant to any one individual or company an acceptance credit exceeding ten per cent of the bank's capital. [P. 48; B. 31.] On the basis of the present capital and surplus of the national banks, the maximum amount of acceptance credit which they would be permitted to give may be estimated at about \$850,000,000. This is a low amount compared with the volume of acceptances which German banks make. There, at the close of 1908, 392 credit banks with a capital and surplus of 3,520,000,000 marks, had outstanding acceptances to the amount of 1,809,000,000 marks, and in addition 587,000,000 marks in acceptances issued by the banks acting in the capacity of sureties or guarantors.*

The acceptance privilege is a new feature in the activities of the national banks. It should also be noted that this right is conferred on them, even if they continue to issue circulating notes. The propriety of giving note banks the acceptance privilege is open to dispute. It is true that notes secured by government bonds are essentially different from those emitted by the central banks on the European continent. We may, nevertheless, well ask ourselves whether the exercise of the right of accepting commercial paper is compatible with the essential nature of a bank issuing notes. This point will be discussed more fully below. [Cf. pp. 143-146.]

It is certainly to the interest of business in America that the use of acceptances should be extended. A necessary condition for such a step is obviously to free the most important and strongest banks from the existing prohibition, as the Aldrich plan proposes to do. The step here taken is of special significance for America's foreign commerce, the financing of which, both as regards our export and import

**Bankenquete, 1908-'09, "Matererrialien zur Frage des Depositenwesens,"* Berlin, 1910.

trade, is today left almost wholly to foreign banks. We quote from the report of the Monetary Commission:* "Take one illustration: Last year we exported about 650 million dollars in value of cotton; it was largely financed by 60 or 90 day bills drawn on Liverpool, London, Paris and Berlin. This business was practically all done by foreign banks or bankers. The banks in the South and perhaps in New York were enabled to collect a small commission on part of the business en route, but the lion's share of the profits accruing from transactions, millions of dollars in amount, were paid to European merchants and bankers, and this vast sum was in the last analysis paid by the cotton planter."

According to Mr. Anderson,† these regulations for acceptances will not altogether remedy the situation, and our foreign commerce will still continue to be financed in Europe to a considerable extent. In certain branches of foreign trade it is customary to use bills having more than four months to run, and special security is not available. Such paper could not be accepted by American banks under the restrictions imposed in the bill. However, it is probable that in the majority of cases the bills arising out of American trade transactions will be of a kind which national banks may accept. This alone would tend to make our export and import less dependent on European banking.

National banks are authorized to invest as much as 30 per cent of their time deposits in mortgages on improved and unencumbered real estate.‡ The loans must not, however,

*Page 29.

†Frank B. Anderson, President of the Bank of California, San Francisco. "Relation of the N. R. A. to the Foreign Trade, and Banks, and the World's Financial Centres." Address delivered before the American Bankers' Convention at New Orleans, Nov. 21, 1911.

‡In the revised plan it was evidently contemplated that mortgage loans should be made not by the banks directly, but by separate savings bank depart-

exceed fifty per cent of the value of the property. By time deposits, as defined in section 39, are meant funds deposited for a definite period, which will not be demanded until after thirty days at least. It applies also to funds which are deposited not for any specified time, but which can not be demanded without thirty days' notice. During the thirty days before the deposits are to be repaid, such funds cease to be available for investment in mortgages.

Lending on mortgages is not consistent with the character and activities of commercial banks. The provisions embodied in the plan are obviously a concession to the demands of agricultural sections, where the need for mortgage loans is but inadequately met. While it is undoubtedly highly desirable and necessary to give proper attention to the financial requirements of our agricultural interests, which are at the root of the country's prosperity, the wisdom of trying to meet the need through commercial banks is certainly questionable. The privilege here accorded to national banks is in defiance of the principles of modern banking.

The Monetary Commission seems aware of the danger to the national banks, should they tie any considerable part of their funds in a form of security that is, comparatively speaking, not readily convertible into cash. It accordingly surrounds the mortgage business of the banks with a number of restrictions. In the first place, the privilege of lending on mortgages is not extended to national banks which act as reserve agents for other banks or trust companies. In the second place, mortgage loans may be placed by banks only on improved real estate in their immediate neighborhood, or in the territory directly tributary to

ments, which were to be established by the national banks. Forty per cent of such savings deposits were to be invested in mortgages. In the Bill as it is now before us, the provisions in regard to savings bank departments have been eliminated, while the other features of the measure have been much amplified.

the bank. These restrictions make for a conservative policy. Banks lending on property in their neighborhood are likely to know the value of the real estate, and whether or not the property could be sold, if any exigency rendered this necessary. The most important restriction on the mortgage business of the banks is found in the requirement that they lend not more than fifty per cent of the value of the property. These various restrictions diminish the objection to the participation of national banks in the mortgage loan business. [P. 50; B. 40.]

VI. Obligations of Membership in the Association

By acquiring shares in the National Reserve Association, a bank undertakes to comply with the regulations of the proposed act. The chief obligations here are publicity, the maintenance of prescribed cash reserves, and the possession of a minimum capital.

Once a month, and oftener on demand, the bank must submit a statement of its condition to the National Reserve Association [P. 59; B. 44]. It must also allow a thorough investigation of its books and its business to be made by representatives of the National Reserve Association whenever the latter deems this advisable. The Association is authorized to accept copies of the reports of national bank examiners, and also of state bank examiners, where the examinations meet the Association's standard, and where it is not against the law of the state to furnish such information. [B. 46.] The reports of the national bank examiners are henceforth to be made out in duplicate, and one copy is to be furnished to the Association for confidential use by its officers and by the managers of the branches. [P. 58; B. 45.]

The existing cash reserve requirements for the national banks are somewhat relaxed in the reserve obligations imposed on the banks belonging to the Association. They may count as a part of their reserves the notes of the Association, which they have on hand, and also their deposits with the Association. [P. 51; B. 39.] State banks and trust companies are authorized to deposit, in the same way as national banks may now do, a part of their cash reserves with other banks belonging to the Association and located in the "reserve" or "central reserve" cities. [P. 62; B. 3.] The same reserve requirements are made applicable to all institutions belonging to the Association. In this way the state institutions are placed on par with the national banks. The percentage of required reserves is determined by the character of the deposits:

(1) On *demand deposits*, the same percentage of reserves must be held as is now required of national banks. This ranges from 15% to 25%, according as the institution is a country bank, a reserve city bank, or a central reserve city bank.

(2) *Time deposits* and money held in trust must be treated for purposes of reserve in the same way as demand deposits for the thirty days preceding the date on which they are to be repaid. Otherwise no cash reserves need be held against such funds. Time deposits and trust funds must, however, be represented by certificates or instruments in writing, and may not be withdrawn before the date specified without thirty days' notice [P. 52, 53, 62, 63; B. 3, 39].

The requirements in regard to capital and surplus now in force for national banks are left undisturbed, and state banks joining the Association are made subject to the same regulations. Trust companies must have a surplus equal to at least twenty per cent of their capital, and a minimum

capital is required of them, varying in amount according to their location. In towns with a population of 6,000 the required capital is \$50,000; in towns having a population of between 6,000 and 50,000, the capital must be \$100,000. The capital requirements rise with the population, and in a city of more than 400,000, the minimum capital is \$500,000.* [P. 61; B. 3.]

Failure on the part of any bank to maintain the prescribed reserves, or to submit the required statements, or misrepresentation of its condition in any report or examination renders the institution liable to suspension from membership by the National Reserve Association. [P. 33; B. 22.] Whether or not such suspension is final, is not made clear in the bill. Presumably it is only temporary, for otherwise there would be need of a clause in the bill requiring a suspended bank to sever its connection with the Association, and to return its shares on repayment of their book value by the Association.

VII. American Banks in Foreign Countries

The establishment of banks in foreign countries (including under this head also foreign and American dependencies) seems at first sight unrelated to the problem of reorganizing the note bank system of this country. In the original draft of the plan these institutions were dealt with summarily. [P. 49.] In the bill, the provisions regulating these institutions have been very much extended. [B. 57.] Closer

*A minimum capital is highly desirable, for it provides a guaranty fund to safeguard the interests of the depositors. It should be noted that the provisions, as they appear in the bill, differ considerably from those in the revised form of the plan. There the minimum capital for a trust company was made \$100,000. The minimum has been reduced as a result of criticism urged against this feature of the plan.

study will show how large a significance these institutions will have for the proposed system of circulating notes, and for American banking in general. The institutions to be established abroad are intended to complete the American banking system and to help in the development of a well-rounded American money market, by keeping it in touch with the movements in the foreign financial centers. They may be used also as fiscal agents of the government and they are particularly well fitted to serve as foreign agencies for the Association. Their purpose is further to help promote American foreign commerce. To fulfill their tasks satisfactorily, these banks must necessarily be in very close connection with the financial movements and institutions of this country. Accordingly the banks belonging to the Association have been authorized to participate in the establishing of these institutions, and to acquire shares of them up to ten per cent of the amount of their own capital stock (in the revised plan the maximum was twenty per cent).

The activities of these banks in the United States have been restricted, as it is clearly not to the interest of the institutions belonging to the Association that these banking corporations should compete for American business. On the other hand, it is not intended that these institutions should become foreign banks. They must remain American banks abroad and serve the interests of American trade. With this in view, the bill sets a minimum for number of shares that must be held by Americans, and also fixes the number of directors who must be American citizens. For the same reason the Comptroller of the Currency has been given supervision over their operations.

The bill permits such banking corporations to be formed by five or more persons. Articles of organization are to be filed with the Comptroller of the Currency, and also with the

Secretary of State, giving the general purpose of the corporation and such regulations as may be adopted for its business. Their certificate of organization must specify the name assumed by the corporation, the foreign country or countries, and their dependencies in which it proposes to operate, the location of the home office, the capital stock and the number of shares into which it is divided, and the names and residences of the shareholders with number of shares owned by each. The certificate must include a declaration that it has been made in order that the Corporation may avail itself of the advantage of this legislation. The bill demands that the annual meeting of each of these banking corporations shall be held at its home office in the United States. At the home office must be kept books containing the names of all stockholders, and of the members of the board of directors, and also copies of the reports furnished to the Comptroller of the Currency, giving the resources and liabilities of the bank.

These banking corporations are obliged to submit statements to the Comptroller of the Currency as frequently as he may require. He may also make an examination of their condition, whenever he deems it necessary, through examiners appointed by him. He is further authorized to appoint a receiver, to close such an institution and wind up its affairs, whenever he is satisfied that it is insolvent. The procedure for this purpose is the same as in the case of a national bank, except where some other method is enjoined by the laws of the country in which a branch is located.

These banks are chartered for a period of only twenty years. The minimum capital required is \$2,000,000, all of which must be fully paid in before the bank may commence business. The payment of the capital must be certified to by the Comptroller of the Currency, and a copy of the

latter's certificate filed with the Secretary of the State. By a two-thirds vote of the stockholders, and with the approval of the Comptroller of the Currency, the capital stock may be increased or decreased, but not below \$2,000,000. The bank may be voluntarily liquidated on the affirmative vote of two-thirds of the stockholders. A majority of the stock must always be held by American citizens or by corporations organized under the laws of the United States, or of the individual states. In the same way, the majority of directors must always be American citizens, and every director must own in his own right at least one hundred shares of the capital stock.

These banks are authorized to make acceptances, to buy or sell bills of exchange, or other commercial paper relating to foreign business, to buy and sell the securities of the United States, or of any of the states of the Union. They may establish branches in foreign countries or their dependencies, and in the American colonies, and these branches may be used by the Government as its fiscal agents. On the other hand, they may not receive deposits in the United States, nor transact any domestic business not necessarily related to their business in foreign countries, or in the dependencies of the United States.

CHAPTER III

Criticism

A. The Plan And The Principles of Banking

The Aldrich plan and the bill have endeavored to meet the sentiment against a genuine central bank, endowed with special privileges and entrusted with the regulation of the note circulation. A novel institution has been devised, differing from the general type of central banks. It has not been deemed desirable to deviate too far from the present system. To quote the words of President Taft in his message to Congress (December 21, 1911), the plan follows "the wise and undisputed policy of maintaining unchanged the main features of our banking system." It may properly be characterized as "the logical outgrowth of what is best in our present system." Nevertheless, the efforts of the National Monetary Commission have not succeeded in disarming all opposition, and the ultimate decision with reference to the Aldrich plan will undoubtedly be based on the question of the general policy involved in creating a central institution.

Criticism of the Aldrich plan has, in general, not concerned itself with the fundamental principles and purposes underlying the proposed legislation. Opposition has been directed against it almost wholly on the ground that the National Reserve Association, whether a central bank or not, is out of harmony with the existing system of decentralized banking.

As the object of the proposed legislation is *to better the credit and currency system and prevent panics*, it is

best to consider first of all the merits of the Aldrich plan as a banking measure and to inquire whether its provisions are adequate for the end to be achieved. Leaving to another place the criticism on political and other grounds, this section will take up the general features of the Aldrich plan from the point of view of banking reform.*

Before taking up the arguments for and against the reforms, it is well to restate briefly the ends sought in the proposed legislation. The purpose of reorganizing the existing monetary and credit system is, in the first place, to insure greater security in crises, and to create some measure of protection against the outbreak of panics. At the same time, the aim is to strengthen the credit basis on which the business of the country rests, and to bring about a better and more equitable utilization of our financial resources, in the interest of all sections of the country and of all branches of our industrial activity. The plan of reform proposed by the Monetary Commission is based on the fundamental belief that, to achieve these ends, the cash reserve of the country must be concentrated in some central agency, that our system of issuing notes must be reorganized, and a market developed for short time loans and discounts. To carry into effect these reforms, the plan proposes the creation of a new type of institution, authorized to issue circulating notes, and charged with the keeping of the gold and cash reserves of the country. The institution advocated, the National Reserve Association, is to be essentially a coöperative union of the existing commercial banks, the vital elements in the present credit system. To the Association are assigned certain functions, enabling it to carry out the general purposes of the plan, and in itself it is to form the keystone in the reorganized system of currency and credit.

*For criticism of particular provisions in the plan the reader is referred to the detailed discussion under appropriate heads in Chapter II.

I. Capital Stock and Reorganization of the Note Issue

The plan proposes for the National Reserve Association a capital stock of \$300,000,000, one-half of which is to be paid in at once in cash. This is a surprisingly large capital for a central banking institution. The objections to an excessive capital are two-fold. In the first place, a very large capital is unnecessary, because institutions of this type secure the funds needed in their operations through the issue of notes and from deposits. In the second place, a large capital makes it difficult for the management to secure sufficient quantity of profitable investments. There would be the temptation to relax the caution necessary in the credit policy of such an institution. With these considerations in mind, the capital of great central banks has been made moderate in amount. It serves chiefly as a guaranty fund and provides the means for acquiring real estate for office purposes.

There is, however, some justification for a large capital in this instance. The national banks have inherited from the Civil War a note system based on government bonds. In consequence, they today hold by far the largest part of the government debt, and this constitutes the chief obstacle to the reform of our note system. A large capital would enable the Association to take over from the national banks a considerable part of the two per cent bonds, and to exchange them for three per cent bonds without the note circulation privilege. Bonds would thus cease to be the sole basis for the note issue, and the note currency would be established, more and more, on the security of lawful money and commercial paper.

The provisions for the reorganization of the note circulation seek to create for the United States a supplementary

currency similar to that now issued by the central banks on the Continent. The two purposes sought are (1) to make the currency elastic and responsive to business needs, and (2) to correlate the expansion and contraction of the note circulation with the movements of trade and industry. To achieve these ends, the plan purposes ultimately to eliminate government bonds as the basis for the issue of notes, and to substitute for them commercial paper,—notes and bills of exchange, and lawful money. The abandonment of bonds as security will make possible a flexible currency, the use of commercial paper as a basis for notes will relate the circulation to business activity. By entrusting the emission of notes to a single institution, instead of thousands of independent banks, a unified policy in the issue of circulating notes is made possible, one that is national in scope, and directed in the interest of the general welfare rather than private profit.

The regulations governing the security of the issue of notes embody the best experience. Provisions through which the change from the present system is to be effected have been drawn with much skill. A sudden discarding of the bonds carrying the circulating privilege was, of course, out of the question. The measures devised for calling them in gradually seem well calculated to bring about the final establishment of the note currency on a sound basis.

The Aldrich plan, realizing that an inflexible limitation on the circulation of a note bank is not desirable, does not impose an absolute restriction on the amount of circulating notes which may be issued. The fixing of a maximum for the volume of notes, as found in the French Bank Act, and the still more rigid method of restriction established by English law, are not examples for imitation. A better restraint on excessive issues is furnished by indirect limitations, exercising control by special requirements in regard to the

reserves to be kept for notes emitted, or prescribing certain characters for the securities on which such issues may be based. These methods are effective, particularly when coupled with a system of restrictive taxation applied to notes issued in excess of a stipulated amount. The Aldrich plan follows this method. It imposes a tax on "uncovered" notes, that is, notes not covered by an equivalent amount of lawful money on hand. The tax is one and one-half per cent on uncovered notes issued in excess of \$900,000,000, and five per cent on uncovered notes above \$1,200,000,000. At the same time, the Association is subjected to a tax for deficiencies in the cash reserve, which it is required to maintain at fifty per cent of the total liabilities, deposits as well as notes. The rate of the tax increases as the percentage of reserves declines. The Association must pay one and one-half per cent for each two and one-half per cent deficiency in the required reserve of fifty per cent.

The regulations concerning the cash reserves mark an advance over those generally in force in Europe. The novel feature is that the cash reserve requirement applies also to deposits. A fixed percentage of reserves against outstanding notes is still obligatory and this feature may provoke criticism. However, the provision carries with it many advantages, particularly in the form proposed. It is not so rigid as the present cash reserve requirement applying to national banks, and is not open to the objections urged against an inflexible reserve. On the other hand it serves to impress on the bank authorities the necessity of proceeding with extreme caution, and of keeping their reserves far above the minimum.

In France no specific percentage of reserves is obligatory. The authorities of the bank are in duty bound to see that there are enough quickly realizable assets to cover their notes; the relative proportion of cash and commercial paper

is left to their discretion. This system has worked well there. In Germany a percentage reserve is imposed, and it is looked upon as a most valuable safeguard against the unhealthy expansion of credit. It is undoubtedly wise to retain the requirement of a definite percentage of reserves for the Association.

An important point not covered in the bill is the denomination of the notes. As the notes will no longer be secured exclusively by government bonds, they will be essentially different from the present notes of the national banks. The existing notes are substitutes for bonds, and as such are in many respects nothing other than paper money. The notes of the Association would, however, stand for credits. This fundamental distinction is clearly pointed out by Mr. Talbert.* He says: "A bank note is a bank credit and is a medium of exchange, not a standard of value." Though it may pass from hand to hand, it does not lose its character of credit instrument. "The debt is merely shifted to 'bearer,' and becomes scattered among many debtors, each of whom stands in substantially the same relation to the bank as the original depositor." This idea implies that the circulation of bank notes should be restricted to those circles which are in fact directly or indirectly connected with the bank, *i. e.*, bank notes should generally be used in business transactions.

Modern legislation has given special attention to this point. Having in mind the nature and purpose of the bank note, the lowest denomination is made £5 for the Bank of England, and 50 francs for the Bank of France. The German Reichsbank did not emit notes for less than 100 marks up to 1906, when 50 and 20 mark notes were authorized. The issue of notes for such small amounts has been

*Joseph T. Talbert: "The Reconstruction of Our Banking System." Address delivered November, 1911.

criticized as not in keeping with the character of bank notes. The suggestion may be ventured that the Association be not permitted to issue notes for less than \$20. There is an abundance of paper in smaller denominations now in circulation in the form of United States notes and silver certificates. Should the Association be authorized to emit notes in smaller denominations, i. e. \$10 and \$5, the amount to be issued ought to be definitely limited in the same way as the issue of 50 and 20 mark notes is restricted in Germany.

Taken as a whole, the measures proposed for the reform of the bank note circulation are well planned and practical. Existing business and banking conditions are taken into account, and made the starting point for legislation. From this point of view, the part of the Aldrich plan that deals with the reform of the note issue is least open to criticism. It aims at introducing a system of currency conforming with modern needs. This it seeks to achieve by gradually transferring the circulation from the banks to a single central agency, at the same time establishing the note currency on a new basis. The notes are to be secured in part by cash. To the extent that they are not based on cash, they must be protected by short time commercial obligations. It will thus be possible to expand and contract the currency in keeping with the demands of business. The greatest evil in our existing bank note system will thus have been removed, and we shall no longer suffer from an inflexible currency unable to cope with the country's requirements.

For the issue of circulating notes the Association will set out upon its work, equipped with ample powers. As, however, the note activities of a central banking institution can not be separated from its other functions, we must consider next whether the other rights conferred on the Association and the limitation imposed upon it are such as

will permit it to exert the vast powers inherent in the note issue to their full extent so that the Association may accomplish the purposes for which it is to be established.

II. The Association in Relation to the Constituent Banks

In prescribing the organization of the Association and defining its activities, the fundamental ideas in the Aldrich plan are (1) to place the institution beyond reach of political influences or control by financial interests; (2) to obviate competition between the Association and the existing banks by limiting the N. R. A. to transactions with the constituent banks only; and (3) to minimize the element of risk in its discount business.

The greatest stress has been laid on the need for making the Association independent of political or financial interests, for only in this way can it hope to win public confidence. Accordingly, the part of the plan that has been most carefully worked out deals with the organization. In view of the detailed discussion of this feature in Chapter II, we may assume here that the provisions of the bill are adequate for the first of these purposes. We pass, therefore, to a consideration of the significance of the restriction of the Association's business to transactions with constituent banks, and the limitations thereby imposed on its activities.

These restrictions in the bill have undoubtedly been adopted not because of their intrinsic merit, but because it was felt that without them there was no hope of effecting any reform. This circumstance must, of course, be borne in mind in criticizing the plan. It is none the less necessary to point out possible consequences and to indicate the modifications which will ultimately be necessary for an effective reform in our credit system.

Originally the Aldrich plan restricted membership in the Association to national banks. To satisfy critics, state banks and trust companies were included. Membership, however, for state banks is dependent on the possession of a minimum capital varying from \$25,000 for a town of 3,000 to \$500,000 in cities having more than 400,000 inhabitants. This provision is in accordance with the requirements imposed on the national banks by the now existing law. For trust companies the required capital ranges from \$50,000 to \$500,000. According to Mr. Strong,* these restrictions eliminate 7,000 out of 12,000 state banks and trust companies. It is, however, justifiable, for a bank ought to have a certain minimum capital to serve as guaranty fund. Moreover, in many cases the minimum is set sufficiently low to make it possible for an institution of consequence to raise its capital to the required standard.

The only point open to question is the propriety of insisting that banks in larger cities must have a very considerable capital to be eligible for membership. Taking into consideration the volume of deposits in cities, and the larger obligations arising therefrom, this requirement seems justified. It is certainly desirable that the capital of such banks should be adequate to meet the greater needs for working funds. The suggestion may be ventured that instead of a rigid rule fixing the minimum capital in accordance with the size of the city, the requirement be based on a stipulated percentage of average deposits. This would mean that even in a large city, a small bank with limited deposits might be admitted to membership with a capital less than the minimum now set. In that case, however, the Association would have to be given the right to compel the bank to raise its capital as deposits increase or to withdraw from the Association.

*Benjamin Strong, Jr., Vice-President Bankers' Trust Company, New York: "Interest Rates, Earnings, Dividends, and Taxation." Address delivered before the Bankers' Association at New Orleans, November 21, 1911.

The feature in the plan most open to criticism is the one limiting the Association's business to transactions with constituent banks. It is the first time in history that a central institution authorized to issue notes is to be made wholly dependent on doing business with certain existing banks without regard to the other financial and industrial interests involved.

By confining the Association to dealings with the constituent banks alone great obstacles are undoubtedly placed in the way of its successful operation. The N. R. A. is thereby cut off from direct relation with the money market and the business world. It becomes an emergency institution with only occasional use for its large funds; it is deprived of a field for the constant employment of its resources. Under such conditions, it is questionable whether the Association can exert any considerable influence on movements in the money market, and it is equally doubtful whether it can achieve the fundamental purpose for which it is being created—that of minimizing the effects of crises or of preventing panics altogether.

The discussion of the activities of central banks in the first chapter has shown that they are able to meet emergencies and to moderate the evils of business depressions and crises, only because their operations are conducted in keeping with a far-sighted policy. Long before a boom has reached its height, these institutions find it necessary to intervene, in order to stem the tide, and to prevent a sudden collapse. They realize that in the event of a sudden breakdown in a speculative movement, even the central bank might not prove strong enough to hold its own and to arrest the panic. Far-sighted policy imposes one absolute condition for the success of a central bank; it must always keep in close touch with the conditions in the money market. Only

in this way can it hope to be properly informed of the course of business developments and the standing of different firms and interests, and only through the money market can it exert its restraining influence before it is too late.

A central banking agency, like the N. R. A., can not obtain this intimate knowledge of the industrial and financial situation, if its business is limited to transactions with banks alone. It is not likely that the banks will seek help from the N. R. A. before they have used up their own funds in loans. With the Association in the field, they will feel the more free to extend their credit to the limit, relying upon it to come to their assistance, in the event of a money stringency. Competition among the different banks, each acting for itself and unable to see the situation in its entirety, will operate to maintain low rates for money in the open market. Hence there is danger that the final outcome will be overexpansion of credit.

While the movement toward expansion is going on the Association whose duty is to prevent overexpansion, will be entirely aloof from the money market. Moreover, even if it does realize the situation, it can do but little. It is not permitted to go into the open market and rediscount bills which it holds, in order to raise the rate of interest in market, with a view to checking the overexpansion of credit. The money market will thus drift along, left to itself, for the Association will be in no condition to control developments. It will maintain its low rate until rediscounts suddenly assume large proportions. The constituent banks, finding their resources exhausted by the claims of private customers and smaller banks, will then seek the aid of the Association. By that time, however, it will be too late for the Association to exercise a preventive influence,—overexpansion will have gone too far to be checked.

The function of the N. R. A. on such occasions will be

but little different from that of the present currency associations, which come into play only in emergencies. It will be able to do but little more than the clearing houses have done in crises. Of these Mr. Andrew* says: "Hitherto the organization of the clearing house committee with banking powers has only been effected after panics have gotten into full swing, and so they have been able only to palliate, but not to prevent them." This is likely to be true also of the Association.

Even the European central banks have more recently experienced difficulty in making their discount policy effective, owing to the growing strength of the large credit banks. Restricted to dealing with powerful banks, eager to enlarge their own holdings of commercial paper, the task of the Association would be doubly difficult. Instead of putting an end to the great fluctuations in the rate of money, the effect of the existence of the Association might actually be to accentuate such fluctuations. The business community would take its cue from the low rate of discount and act upon it, failing to realize that an overexpansion of credit was going on, until awakened to the fact by a sudden rise of the discount rate.

From this point of view, there is, indeed, ground for believing that with the restrictions imposed in the bill the existence of the Association might become a cause for overextending credit. This might happen, not because the N. R. A. would be too liberal with its credit, but because its low rate of discount would lead to false inferences and a mistaken sense of security. Reliance would be placed in the Association's help, and the facility with which a single bank could secure funds might lead others to a rapid expansion of credit.

*A. Piatt Andrew, at Indianapolis, cited in the Introduction.

Mr. Anderson* has justly pointed out the evils that are likely to come from such intermittent activity of the Association, and we quote from him: "The thought naturally arises, Will the mere fact of the directors of the National Reserve Association naming a rate have any effect when their hands are so tied that they have no way of enforcing the rate and of making it so effective? . . . The Association will not have any control over the situation until the demands of the great mass of non-member banks have put such a strain on their reserve city banks, who are members, as will drive those banks to the Association for help. If it had the power to sell in the open market, it would force contraction, and it is only through contraction that it can prepare itself to fulfill its responsibilities towards the banks."

The criticism of the provision in the Aldrich plan limiting the Association to business with the affiliated banks has been met by Senator Aldrich with the statement that in Europe a similar situation has come about, and that the great central banks do not transact business in the money market. This rests on some misunderstanding. It is true that the central banks do not participate generally in the market for bills of the very highest character, the so-called "open money market," where the "private" rate of discount prevails, a rate below that of the note bank.† This does not mean, however, that individuals can not deal directly with the central bank. On the contrary, all business men who have an account with it can get their bills discounted there at the "bank rate," or "official" rate of discount, which is the general rate applying to ordinary bills. That Mr.

*Frank B. Anderson, President of the Bank of California, N. A., San Francisco: "Relation of the National Reserve Association to the Foreign Trade, and Banks, and the World's Financial Center." Address delivered before the American Bankers' Association at New Orleans, November 21, 1911.

†See Chapter I., page 34.

Aldrich is mistaken can be readily proved by reference to the statistics of the Reichsbank. Among the data obtained by the German Bank Inquiry is a table prepared by the Reichsbank, giving an analysis of its customers by classes, together with the average amount of paper discounted for each class in 1907. It appears from the table that on the average the commercial paper discounted by the bank during 1907 amounted to 1,060,000,000 marks, and that of this total only about one-half had been rediscounted for banks and bankers.

Those utilizing the central bank's facilities may be classified as follows:

TABLE 7.—CLASSIFICATION OF BILLS DISCOUNTED BY THE GERMAN REICHSBANK, 1907.

CLASS	Average Amount of Discounts (millions of marks)	Percent of Total
Trade, transportation, and insurance.....	187.9	17.73
Industry.....	284.4	26.83
Agriculture.....	11.1	1.05
Other borrowers exclusive of banks and bankers.	16.6	1.57
Total.....	500.0	47.18
Money and banking interests.....	560.0	52.82
Grand total.....	1,060.0	100.00

In England and France, indeed, the relations between the central bank and business interests are not so direct as in Germany. There the industrial and mercantile classes usually transact their business with the credit banks, and the customers of the central bank of issue are as a rule banks and bankers. To this circumstance we may trace the appellation of "bank of banks" applied to the Bank of England and the Bank of France. However, this means only that financial interests furnish the greater part of the customers

of the bank; they do not enjoy exclusive privilege to do business with the central institution. Moreover, it should be noted that even in its relations to banks, the position of the central note institutions of England and of France is different from that contemplated in the Aldrich plan. There the entire financial world without exception is admitted to do business, and not a limited number. All banks and bankers are equally entitled to have their paper discounted at the rate applicable to any one of them.

The Bank of France has made special efforts to democratize its facilities, *i. e.*, to make the institution serviceable to the small merchant and manufacturer. For this purpose, in 1897 a reduction was made in the minimum face value of bills that would be accepted for discount, the amount being reduced from 10 to 5 francs. The annual report for 1910 shows that of 8,091,315 bills discounted more than one-half (4,452,300) were for amounts not exceeding 100 francs. In commenting on these figures, the bank emphasizes the fact that there has been a continued increase in the number of small notes discounted since 1897, the percentage rising from 33% in that year to 55% in 1910. The report goes on to say that, in accordance with the terms of its charter, it has always been the policy of the bank to extend its facilities to small business men. This statement is confirmed by Mr. Patron, one of the experts of the Monetary Commission.*

Whatever the situation in England and France, these countries can hardly be used as models for the reform of the American credit system. Conditions there are vastly different. France is preëminently a creditor nation, lending its capital to the rest of the world, but in itself of less

*Maurice Patron: "The Bank of France in Its Relation to National and International Credit." Publications of the National Monetary Commission, Document No. 494.

industrial importance. England, too, can not be used as a model; the testimony of Mr. Wood* on the great similarity of British and American business conditions to the contrary notwithstanding. Such similarity is more apparent than real; it extends merely to certain external features, principally the specialization in banking and the extensive use of the check and clearing house system. English and American economic conditions are radically different. England's production is indeed large and important; nevertheless the economic significance of England rests chiefly on its activity as middleman, and above all as the international money-broker.

The position of the United States is very much different from that occupied by England. Its internal activity is so great that its own capital becomes inadequate whenever trade is brisk, and it is compelled to call for additional funds from abroad. The condition of Germany is strikingly similar: its industries are being developed at a rapid rate, and, as in America, the national life centers about them. Germany is not a country with capital to lend. It invests abroad only where such investments are necessary to further its industrial and commercial expansion. So far as analogies can be drawn between America and Europe, Germany is the only country which possesses many characteristics in common with the United States.

To the extent that European models can be followed for the reorganization of the banking system, no institution can be imitated to better advantage than the German Reichsbank, and no better feature in its activity can be emulated than that of keeping in close touch with the entire industrial community. Its policy is in striking contrast with that of the Aldrich plan. The latter adopts the undesirable de-

*Edward R. Wood, A.M., LL.B.: "As to Suggested Plan for Monetary Legislation with Detailed Account of Bank of France."

velopments in the European system. It further emphasizes them when it fails to admit all banks to dealing with the Association and surrounds the transactions of even those banks which are privileged to do business with it, with excessive restrictions. The Reichsbank is aware of the danger inherent in the position of a bank for banks alone. Knowing that banks utilize its facilities only at intervals, when money is tight, it has made every effort to maintain direct relations with industrial and mercantile interests. It realizes that unless it is able to keep on hand a large volume of commercial paper obtained directly from these classes, it will soon find itself out of touch with industrial movements. This is likely to be the fate of an institution, like that outlined in the Aldrich plan, withdrawn from direct relations with the business world and made dependent on a limited number of banks.

It would not be the case if the Association were allowed to discount more freely both for the public and the banks. As a large purchaser of bills it would be able to survey the situation, and could endeavor to influence the rate for loans in the general money market in time. Its control of a large volume of paper would enable it to work for a higher rate, in order to check an unhealthy expansion of credit, and thereby to prevent crises. [See Chapter I, pp. 39-40.]

In the existing situation, however, it would scarcely be possible to bring about the establishment of a central banking agency authorized to deal directly with commercial and industrial interests. Public sentiment is not prepared for a central bank endowed with special rights and privileges, and permitted to compete in what is today regarded as a field for private enterprise. This must be admitted, and a large extension of the freedom of the Association can not be expected.

Nevertheless, in the effort to prevent competition between

the N. R. A. and existing banking institutions, and to minimize the volume of risk in its activities, the Aldrich plan, as embodied in the bill before Congress, goes too far. It puts the Association entirely out of touch with the money market, and unnecessarily hampers it in the discharge of its proper functions. In the first place it excludes from the possible clientèle of the Association a very considerable number of banks, and all private bankers. In the second place, discount transactions between the N. R. A. and its constituent banks are subject to considerable limitations.

A guaranty from the local association is in certain cases made a condition of getting credit facilities from the Association. Such a guaranty is necessary whenever a bank seeks to discount commercial paper maturing after twenty-eight days. The requirement renders transactions with the Association inconvenient and costly. The bank seeking to rediscount paper must pay a commission to the local association for its guaranty. The commission adds to the expense of dealing with the Association. More important as a deterrent than the cost, will be the reluctance of an institution to expose itself to criticism of competing banks in applying for such guaranty. It follows therefore that the constituent banks will generally not offer for rediscount paper running more than twenty-eight days, but will use bills maturing within a shorter period. In some respects, this would be an advantage for the Association. Its stock of bills discounted would in the average fall due within a few days. Such a condition is, certainly, desirable for a note institution, provided that it is employed continually in discounting bills, and thus is always in close touch with the market. Under the proposed provisions the Association would in all probability not be in that position. The limitation of the discount facilities to member banks in itself works only for the periodical employment of the Association. The re-

quirement of a guaranty by the local association will necessarily further a development in that direction. As the member banks can not well use long time bills for rediscount, and as their stock of short time bills is limited, they will give these to the Association only when the need is urgent. Thus the final outcome will probably be that the constituent banks will seek aid from the Association only in exceptional cases.

If it is at all desirable to give the Association a field for the adequate employment of its capital, this feature of the Aldrich plan should certainly be modified. In any event the relations with the constituent banks should be made as simple and direct as possible. To facilitate transactions with the Association, and the use of its funds for rediscounts, the guaranty should not be obligatory on rediscounting of ordinary bills having more than twenty-eight days to run. The modifications here suggested would be in the interest of the smaller banks. These will have more frequent occasion to apply for rediscounts than the larger institutions, which have greater resources. The guaranty should be required only when a loan is made on the direct obligation of a bank in an emergency, where it is necessary to save an institution from failure. There is no reason why the Association with numerous branches and an efficient credit department, should not be able to carry on its credit operations with a minimum of risk. The great European central banks have always found it possible to do so. Unless transactions between the Association and the banks are made simple and easy, the Association will not obtain a sufficient volume of bills for discount to make it a factor in the discount market. It will be unable to exert any restraining influence upon the money market, and to that extent it will fail to realize the purposes for which it is to be established. Short time notes will indeed be presented

for discount shortly before maturity, largely for purposes of collection, but these can not suffice to occupy the Association, and it will time and again find itself with so little paper in its discount portfolio that it can neither keep in touch with the situation, nor exert a regulating influence on the money market.

In regulating the discount policy of the Association, the Aldrich plan provides for a uniform rate throughout the United States. The fundamental assumption is that it should be the duty of a central institution to extend capital to poor districts on terms as advantageous as those obtainable in richer sections or in financial centers. The purpose is commendable in theory; practically, it is not so laudable.

If the Association's rate of discount proves effective, districts accustomed to dear money are likely to be stimulated by relatively cheap money to increase their demands. This would have the effect of forcing the price of funds above the level formerly prevailing in the old industrial centers. In such an event, sections where money has been cheap will not be attracted by the higher price demanded by the National Reserve Association. Mr. Morawetz* urges this objection to the plan. If his view is correct, few bills would be offered to the Association for discount in the large financial centers of the East, because the rate would be, relatively speaking, too high for them.

To encourage all sections to utilize the discount facilities of the Association, it would not be amiss to permit a lower rate of discount for exceptionally good bills. An example for such action may be found in the history of the Reichsbank, which in earlier days used to discount such paper

*Victor Morawetz: "The Banking and Currency Problem and its Solution," New York, 1911.

at favorable rates, when money was abundant. It is a question, however, whether any provision could be incorporated in the bill, permitting the Association to discount below the official rate. With the existing antagonism against large business interests, the cry would be that such discounts simply concealed a way of favoring Wall Street. This, of course, would be far from the real motive, for it is much more important to the central institution than to Wall Street to keep on hand paper of the highest type as security for the outstanding bank notes. Moreover, the Association is forbidden to discount bills that originate in other than mercantile transactions. Its funds, therefore, could not be used for stock speculation. By permitting the N. R. A. to consider the high character of a bill offered for discount as the basis for a preferential rate, the above objection would be overcome. Then, no matter where the paper originated, if it met the requirements of a "prime" bill, it would be entitled to the lower rate and an uniform rate would continue to obtain for ordinary bills.

The necessary complement to the discounting activities of a central bank is its gold policy. It must safeguard the gold reserve of the country. For this purpose, and in order to strengthen its own position, the most effective means is to raise the rate of discount. As such a step serves to make credit dearer, and imposes a burden on borrowers, the bank tries to avoid raising its rate, unless the trade conditions leave it no choice. The gold policy of the central bank seeks, therefore, to obviate the necessity of increasing the rate of discount. In the last analysis this means that the bank makes every effort to draw gold from abroad by buying the precious metal in bullion or in foreign coin, and that it endeavors to prevent the export of gold by selling part of its holdings of foreign bills of ex-

change for use in settling indebtedness to other countries.

As guardian of the gold reserve the Association is authorized to deal in gold coin and bullion. In order to borrow gold it may pledge its holding of government bonds as security. To facilitate the carrying out of its gold policy, it may purchase and sell foreign bills of exchange. In these activities the Association is not so rigidly confined as in its other operations. It may do business abroad, establish agencies, and open accounts with foreign banks.

Owing to the limitations on the domestic business of the Association, it will probably be obliged to lay stress on this branch of its activities. Finding difficulty in investing its funds at home, it will be compelled to purchase foreign paper on a large scale. The outcome may thus present a curious situation. The central note agency of the United States will be investing its funds abroad and using its credit resources for the benefit of foreign countries. It may mean that, under certain circumstances, its credit will be offered on more favorable terms to foreign than to American borrowers. The Association is likely to add American funds to the discount resources of European money markets, leaving the American borrower to seek accommodation there as in the past. Bankers not permitted to deal with the Association directly would be, as previously, the intermediaries for the sale of American commercial paper in the international money market. Instead of securing the needed credit from the central institution established for the purpose, American borrowers would have to continue to pay a premium to foreign countries for discounting their bills of exchange.

An illustration may serve to make this clearer. Let us assume that the Association, having funds to invest, purchased bills in Paris. Through an agency established there, or through a correspondent, it would buy first-class paper at the private rate of discount, that is, at a very low rate.

While the Association was thus lending abroad, an American bank not belonging to it might try to secure funds for its clients by rediscounting their notes. With money dearer in New York than at Paris, it would draw on that city, paying the Paris bank a commission for the draft in addition to the rate of discount there prevailing. In turn, the bank would be obliged to charge the ultimate borrower, the merchant or manufacturer, with the expense of getting funds from abroad, exacting in addition some compensation for its own services. Thus, because the non-member bank can not get accommodation from the Association, the American business man may be forced to seek funds abroad, and pay a high price for perhaps the very money placed at a much lower rate of interest by the Association. The American borrower may even in that case secure his money more cheaply in Paris than in New York, but meanwhile the Association is giving funds to Europe at a still lower rate to the detriment of home interests. The difference between the rate of interest earned by the Association in Paris, and the expense incurred by the American borrower in the same city is a net loss to the United States. If, however, the New York bank could rediscount the notes of his customer with the Association, there would be a saving, at least to the extent of the commission now paid to the foreign bank. Furthermore, if business men were allowed to deal directly with the Association, they might save also the commission now paid to the American banker.

A large volume of foreign bills of exchange is, of course, a highly desirable asset for the Association. But the primary purpose of the N. R. A. is to meet the needs of this country. Its holdings of foreign paper ought not exceed the amount which the bank needs for the uses of the domestic money market. The function of the Association is to help the business of the country, and its foreign transactions must

be only a means to this end. It would be a strange paradox if on account of the restrictions imposed on its business at home, the Association would find itself obliged to lend its funds abroad.

There is, moreover, a limit to the foreign bills of exchange which the Association could buy. This is set by the rate of exchange. When the balance is against America, foreign commercial paper could be purchased only by paying for it in gold. To export gold for such a purpose would, however, be out of harmony with the policy of safeguarding the gold reserve of the country. Confronted with an adverse balance of exchange, the Association would, on the contrary, be obliged to part with its holdings of foreign paper, although it would thereby curtail the opportunities for employing its funds.

In the last analysis the successful management of the gold reserve is essentially bound up with a farsseeing discount policy. With the limitations imposed on the Association, it does not seem fitted to cope with the task. From the standpoint of an ideal banking system, this defect constitutes a very grave objection to the proposed plan of reorganization.

Among the improvements introduced in the banking organization by the Aldrich plan is a system of domestic exchange, or the transfer of funds for depositors on the books of the Association to the credit of other depositors. It is contemplated that the Association, its branches, and also the local associations should engage in this transfer of funds, which is to be conducted on the clearing-house principle. The scheme suffers from two drawbacks. In the first place, the scope of the domestic exchange system is, in itself, very much restricted by the general provision limiting the Association to business with members only. In the

second place, the service is not to be rendered free of charge, a circumstance which will militate against the wide use of the Association's facilities for the transfer of funds. It is hard to see why the Monetary Commission should not have followed more closely the German system, which is a model in this respect. There this service is rendered free. The expense is more than offset by the profit derived from the use of the funds to be transferred. Thus in addition to the minimum deposits which the German Reichsbank requires for a "giro" account it has on hand an average of 120,000,000 marks, representing what may be called money in transit, *i. e.*, funds over which it has control from the time the order for transfer is given by the customer until the time that they are credited to the payee. The period elapsing is usually one to two days in Germany. Here, with greater distances, the period would be longer, and larger sums would therefore be on hand until such transfer is completed.*

III. The National Banks under the New Conditions

The proposed legislation would affect the national banks, —the present banks of issue—in two ways. It imposes restrictions upon them to the extent that it limits their right to issue bank notes. On the other hand, it confers additional privileges.

The privilege of the national banks to issue notes is gradually to be given up by them and transferred to a central agency. The bill provides that no bank can increase its present circulation, and that whenever any part of its present circulation is retired, it loses the right to reissue such notes. Account is taken of the existing situation and the banks are given an opportunity to dispose of the two per

*Where transfer by telegram is required the expense could be, of course, charged to the customer, as also a small fee.

cent bonds by which their notes are now secured, and which on that account have a higher value than the rate of interest justifies.

The Association is obligated to take over these two per cent bonds at par, if offered during the first year after its organization. The terms should prove an inducement to the banks to abandon their circulation privilege, for there is little prospect that they would ever again have as good an opportunity to dispose of their two per cent bonds at such a high price. The period for the banks to accept this offer has been made brief to secure prompt action. The provisions of the bill for the retirement of the two per cent bonds are calculated to pave the way for centralization in the issue of the notes, and the establishment of the circulation on a better basis than government debts.

Whether or not the inducements thus held out to the national banks are sufficient to bring about the surrender of their note privilege is open to question. They may now retire their circulation, and sell their bonds, when the note issue is unprofitable, resuming it again when their notes can be issued to advantage. If the proposed bill is enacted, banks for whom the circulation is only intermittently profitable, will retire their circulation, surrendering their bonds to the Association, rather than face the possibility of being forced to sell them later on, considerably below the price now offered. Banks anticipating no difficulty in keeping their notes in circulation will have less inducement to sell their bonds to the Association. In view of the importance of centralization in the issue of circulating notes, and the urgent necessity of substituting for the bonds now used as the basis of the circulation, a security that will better meet the needs of a satisfactory currency system, it would seem advisable to resort to more effective means, in order to bring about the early retirement of bond-secured bank notes.

While the privilege of issuing notes is thus restricted, the rights and powers of the national banks are extended in several directions. They are permitted to treat deposits with the Association as part of their legal reserves. Their field of operation is enlarged. They are allowed to make acceptances. Under certain limitations, they may lend on real estate mortgages. They are authorized to participate in the founding of American banks abroad, and to hold shares of them. They are further favored in another way. While membership in the Association is not exclusive, and state banks and trust companies share with national banks in this privilege, the standards set up for membership are mainly those that now apply to national banks.

These concessions are evidently intended, at least in part, to compensate the national banks for the surrender of their circulation privilege. The permission granted to make acceptances and to lend on real estate mortgages helps to place the national banks in a better position. It enables them to compete on more equal terms with the state banks and trust companies, institutions which have hitherto enjoyed greater freedom from legal restraint and which have in consequence grown very much more rapidly. State institutions are to be admitted to membership in the Association only on complying with certain requirements in regard to capital and reserves to which national banks are now subject. The admission of state banks and trust companies is thus restricted, and such institutions as qualify and enter will find themselves obliged to submit to the same conditions as the national banks. All will be substantially on an equal footing.

Under the plan, as now developed, participation in the Association will confer an important and valuable privilege, for the benefits of the Association are to be open directly only to members. Outside banks will be able to use its facilities only through the mediation of members of the Asso-

ciation. Only the latter can have their notes discounted by the Association, and the profits from its business accrue to them alone.

In permitting national banks to invest a certain percentage of their time deposits in mortgages, the privilege is restricted to institutions that are not reserve agents. This feature was doubtless incorporated in the plan with a view to granting to national banks rights now enjoyed by state institutions. Whatever the arguments may be in favor of extending the market for real estate mortgages, this privilege is not compatible with the fundamental character of a commercial bank.

To a large extent the rights and privileges granted to the national banks have their justification in deeper motives. They are essential parts of the plan of reform. The new powers are bestowed because they make possible the concentration of the cash reserves of the country, and the creation of a general as well as an open money market. They thus serve the ends of the Association and are prerequisites for improvements in our credit and monetary system.

Permission for banks to count deposits with the Association as part of their legal reserves will supply that institution with an abundance of ready cash. It will become the central reserve agent, holding the reserves of the nation. Banks will have a motive for keeping deposits at all times with the Association. They will find this a great convenience in making settlements with each other. In Europe a similar situation has developed of itself, without any effort to bring it about through legislation. There the banks carry very little cash in their own vaults. They deposit the greater part of their reserves with the central institution, because they can obtain currency from the central bank, as they need it.

Banks belonging to the Association will, moreover, have special reasons for keeping their reserves on deposit with that institution. The right to have bills discounted is open only to constituent banks carrying deposits. Another factor leading towards the same result is that the Association, with its domestic exchange organization, can transfer funds from one customer to another. This system will do much to facilitate transactions between banks and make the Association a national clearing house, provided the service is rendered free.

With large cash resources, flowing in upon the Association from its connection with the government and with the banks, it ought to be in a position to provide the country with an elastic currency, and to give proper support to the banks and to the credit system as a whole. The presence of so powerful a support for our banking organization should strengthen public confidence in the safety of our financial institutions, and serve to check panics. In the event of trouble in a given locality, the central agency will be called upon to extend help to the endangered banks, and to prevent the spread of distrust, by stifling the panic at its very inception.

Besides the concentration of the cash reserve, there is another motive which prompted the extension of the rights of the national banks. It is the desire to organize an American money market for short-time loans and discounts. The full development of such a market has hitherto been hampered, because we have no extensive transactions in commercial bills. To the authors of the plan fell the task of so modifying conditions as to favor the fuller development of a money market.

In devising the Association one prerequisite for a money market is furnished. The Association makes possible the conversion of commercial bills into currency. The other

requirement for a market in commercial paper is a large volume of high grade bills, sufficiently vouched for to make them acceptable investments and easily negotiable. We have suitable material even now in the shape of promissory notes and drafts of business men which can be evolved into bills answering the needs of a discount market. In its present form, however, this paper has a limited value outside of the locality where the firm or company issuing it and its business standing is known. What has been wanting almost entirely is the so-called prime discount, paper bearing such names as make it universally acceptable. Such first-class bills are negotiable anywhere, and can usually be discounted at the "private" rate, that is, below the general rate for discounts. Where there are considerable transactions in commercial paper, these "private discounts" set the standard for the market.

America has now little paper of this character, chiefly because the national banks are not permitted to accept or endorse bills, and because there is no central agency where bills can be rediscounted when ready cash is needed. Extensive and regular transactions in bills are possible only in paper the value of which is established beyond question. Without such paper, no market of any consequence could be developed. The need of that type of commercial paper available for private discount has been particularly felt in connection with our foreign trade, and its absence has made us dependent in our export and import business on European banks and bankers.

In order to meet the need and to provide commercial paper of the character required, the plan allows national banks to make acceptances. Bills bearing the signature of national banks of high repute will at once become available for purchase and sale in the open money market. They would meet the requirements of a prime bill, as they

carry with them the certainty of prompt payment at maturity, in the form of the guaranty of a reliable and well known bank. They could be used in settling obligations in international trade. First-class paper of this kind would always be in demand in the money market, and therefore be negotiable at any time before maturity and on especially favorable terms, that is, below the general rate of discount.

American acceptances of the type described would be more particularly fitted for their part in the national and in the international money market in connection with the activities of the American banks which it is proposed to establish abroad. For that reason these institutions will be of great assistance in the development of our banking and commerce, and it is, therefore, very important that they should always be intimately related to the domestic banks. To assure permanent control by American interests, national banks are allowed to participate in the founding of these banks abroad, and to hold shares of them. It is also a condition of their charters that the majority of their shares must at all times be held by American citizens, who are also to constitute the majority of the boards of directors.

The introduction of acceptances is undoubtedly a great step in advance towards standardizing bills of exchange, and creating a market for commercial paper. As Mr. Warburg* maintains, "Before there can be in America a money market of international significance, a system of bank acceptances is necessary." It is therefore most desirable that our banks should be permitted to accept commercial paper. On the other hand, in conferring the privilege of accepting bills on banks authorized to issue circulating notes, a distinct departure is made from the existing practice here and

*Paul M. Warburg, of Kuhn, Loeb & Co., New York City, "Circulating Credits and Bank Acceptances." Address delivered before the American Bankers' Association at New Orleans, November 21, 1911.

abroad. The objection is perhaps not so great under the present American system of notes secured by the deposit of government bonds, as it would be under the continental system of circulation based on commercial paper. Undeniably, however, the exercise of this privilege is not compatible with safe and conservative banking. As long as the national banks retain their circulation privilege, it is not proper to grant them the right to make acceptances. The safety of the note circulation is dependent on careful supervision and control of all the varied activities of the banks. This is the purpose of detailed regulations by law. The work of a bank in accepting commercial paper is a phase of its activity which can be least controlled and kept within safe limits by formal legal restrictions. In time of financial unrest and uncertainty, this phase of banking may lead to serious difficulties, for the bank is liable to be called upon to make good its guaranty if the author of an acceptance fails to pay. In a crisis or a panic, the note bank would thus have to satisfy obligations arising from its acceptances, just when it is hardest pressed to meet other urgent demands.

These objections are met in part by the restrictions imposed on the acceptance privilege. The total volume of the acceptances that any bank may make is limited to an amount not exceeding one-half of its capital and surplus. The attempt to safeguard the exercise of the right to make acceptances against misuse, and to minimize the dangers connected with it, is certainly justified, particularly so long as the national banks are permitted to continue the issue of circulating notes. The means, however, are unsuited for the purpose. By limiting the volume of acceptances to a specified amount, little is accomplished towards placing this branch of banking on a safe foundation. Much more important than the total amount of acceptances which the

bank may have outstanding is the character of the bills accepted, the standing of the firms or companies for whom they are made, and their ability to pay at maturity.

A mechanical limitation on the volume of acceptances may, on the other hand, prove at times a serious hindrance to a bank in the pursuit of a legitimate and desirable acceptance policy. The restriction is purely formal and has, therefore, the serious drawback of making the distinction according to the quantity rather than to the character of the paper offered for acceptance. Whenever the volume of a bank's outstanding acceptances approaches the legal limit, it would have to refuse to accept notes for a client regardless of his needs or the character of the security offered by him. The effect of this restriction would probably be to throw a large part of the acceptance business into the hands of banks not affiliated with the Association. Commercial paper accepted by them would be discounted in the open market, or at banks belonging to the Association.

Limitation on the amount of acceptances which a bank may make is superfluous in so far as it applies to institutions which do not issue notes. It would be better to abandon the restriction, because a rigid requirement will do no good, and may at times work harm. Banks which do not issue notes can be safely left to themselves in the management of their acceptance business, for they are not so greatly exposed to the dangers connected with acceptances as banks of issue.

In considering the significance of the acceptance privilege a natural question is, What will be the effect on the banks? Will it tend to induce overexpansion of credit through the use of acceptances? This fear may be considered as groundless. The existence of an adequate money market will of itself prove the best corrective. Each bank will find it to its interest to preserve a favorable market for

its acceptances; it will see to it that they can be discounted at the "private" rate. In order that its paper should be regarded as "prime discount," the bank must not come too often into the market as borrower, and its acceptances, purchased by other banks, must not be offered too frequently for discount. In this way the open market affords an automatic check on credit inflation from that source. Therein is its great significance, and its value to the United States will early become manifest. The effect of introducing the system of acceptances and of building up a money market for discounts will not weaken the American credit organization; on the contrary, it will establish it on a far firmer foundation.

IV. Suggested Modifications for the Aldrich Plan

The criticism of the provisions of the Aldrich plan from the point of view of their importance for banking serves to indicate the directions in which changes and improvements are desirable. Detailed examination of the various features leads to the conclusion that, in fundamentals, the plan conforms with the requirements evolved from the world's banking experience. Without a central institution of the type planned, empowered to issue an elastic currency and entrusted with the keeping of the cash reserves of the country, no real reform is possible. Without it, we can neither establish the credit system of the country on a safer foundation, nor build up a market for short-time loans and discounts, so necessary for the advancement of the manifold interests of the country.

While the essentials of the Aldrich plan are sound, there are several defects in the legislation proposed. These defects are likely to hamper the Association in its business

activity, to prevent the realization of some of its purposes, and to interfere with the complete success of the plan.

There is ground for doubting that the provisions of the bill will suffice to bring about centralization in the note issue. We can not be certain that the inducements held out to the national banks to renounce their circulation privilege are adequate. To the extent that they fail of this purpose, the ultimate object of the reforms is not realized, namely, the abandonment of the present inelastic bond-secured currency. Moreover, the notes of the Association will not fulfill their purpose unless they become an essential part of the currency system. It is thus doubtful whether we shall be able to carry out early what is declared to be the policy of the government, "to retire as rapidly as possible, consistent with public interest, bond-secured circulation and to substitute therefor notes of the National Reserve Association."

The privilege of accepting notes and drafts, and of investing in real estate mortgages might well be used as an inducement to the national banks to abandon the right to issue notes which they now enjoy. The surrender of their circulation, thus brought about, would mark a decided step in advance towards the policy of centralizing the note issue and abandoning bonds as a basis for circulating notes. Such measures would also meet the objections against granting these privileges to note banks, even though it is not probable that the national banks would be led away from conservative banking practice by the new privileges. The limitation on the volume of paper they may accept to a percentage of their capital and surplus, the restriction of the proportion of their funds which they may invest in real estate, are provisions making for safety. Of themselves, they do not, however, constitute sufficient safeguards. This is particularly true of the acceptance business of the national banks. Here the factor determining the safety of the institution accept-

ing drafts, is the character of the paper itself, rather than the volume of outstanding acceptances. Should the national banks voluntarily surrender their note circulation, the objection to this phase of the Aldrich plan would be done away with.

The criticism urged against the plan because of its limitations on the business of the Association is even more vital. There is danger that the restrictions on the Association will not only prevent it from exerting a restraining influence on the money market, but that they will also make it difficult for the Association to maintain its own position. Some critics of these features in the plan go so far as to assert that they incapacitate the Association, making it impossible for the institution to fulfil its purpose of safeguarding the credit system.

The teachings of banking experience in all countries show that the money market can not be entirely left to itself. There is need of a guiding and, at times, a restraining force over its movements. Else the danger is that credit expansion and speculation will go so far that in the end the help of the central bank will not avail. If the Association is to be subject to the restriction and limitations with which the plan would encompass its movements, we may well ask ourselves whether it will be able to exert the potent influence which it ought to have in the money market.

In confining its domestic activities to business with its constituent banks, it would seem that the Association might be precluded from finding adequate employment for its resources, and that it may not be able to obtain any considerable volume of domestic bills for discount. In that event it would be out of touch with movements in the business world, and would not have sufficient power to enforce its discount policy in the money market. Furthermore, the obligation to maintain one uniform rate of discount for the country as

a whole may have the effect of excluding practically all of the best commercial paper or prime discounts from its portfolio, as these are most likely to be able to obtain better terms from other sources. Finally the limitation placed on the possible clients of the Association will in all probability force that institution to discount foreign bills of exchange on a large scale, with the result that its resources will be used in the interest of other countries.

We are thus confronted with a strange and contradictory situation. The Association itself would be most carefully safeguarded from a possible overexpansion of its credit, a danger that scarcely exists where the management is at all conscientious. On the other hand, it is deprived of the means of checking in time a movement towards overextending credit in the money market, a danger which is real where the money market is left free of control.

Special circumstances, not connected with the monetary and banking needs of the country, have doubtless dictated certain of the provisions as they now stand in the bill. From the point of view of the requirements of monetary and credit reform, and for the reasons here given, it would appear most desirable that the activities of the Association should be extended to meet these criticisms. The directions in which changes are needed are again indicated below:

1. In order that centralization in the issue of circulating notes may be ensured, the national banks should be required to exercise their present right, subject to all existing restriction, or to surrender their circulation in exchange for the privileges conferred by the proposed act, viz., membership in the Association, the right to accept commercial paper, to invest in mortgages, and to hold shares of banks established abroad.

2. To make possible an effective discount policy

on the part of the Association, the following rights should be conferred upon it:

a. To do business not only with members, but also with individuals and establishments carrying certain minimum deposits; at least it should be permitted to deal with *all* banks and bankers.

b. To discount notes and bills for non-members; the rate of discount should, however, be higher than for banks belonging to the Association.

c. To purchase prime bills at less than the official rate, whenever the latter falls below a certain level. In such cases—as in the discount of ordinary bills—the Association should be permitted to favor the constituent banks by discounting prime bills for them at a lower rate than for non-members. The preferential rate, that is, the rate open only to members, should, however, always be published alongside of the general or official rate.*

From the standpoint of modern banking there can be no objection to the amendment of the Aldrich plan along these lines. The members of the Association would still enjoy a privileged position in that they alone would be entitled to lower rates of discount. The vested interests of the national banks are respected. In exchange for the cir-

*Another way of increasing the influence of the Association in the open market would be to authorize it expressly to rediscount bills there. It would thus be in a position to appear in the market as a borrower, and prevent the rate of interest from falling too low, thereby obviating a large discrepancy between the market and bank rate, and keeping in touch with developments. It is not clear whether the Association has the right to sell its holdings of paper under the present plan. Moreover, there is good ground for not deciding in advance whether a new institution, like the Association, should or should not have this power. It is better to wait for developments, and to allow the experience of the institution to guide.

culatation privilege they would be given new and valuable rights. Their independence and freedom of action would moreover not be materially impaired by the extension of the powers of the Association as here advocated. Even with these amplifications the plan of reform would not lay violent hands on the cherished ideal of decentralized banking as it now exists in the United States.

B. The Opposition to The Aldrich Plan

The objections to the National Reserve Association thus far raised have been based largely on political grounds. The plan has been made the object of partisan attacks, and it is clear that much will have to be done to enlighten public opinion before legislation can be had. Opposition has been expressed to any institution whereby the economic welfare of the country is placed in the hands of a small group of men, and statements have been made that the proposed central agency will add to the influence of Wall Street.

It may be thought that arguments like these have their origin exclusively in political partisanship. However, the same attitude is taken by men of affairs, who base their opposition on similar inferences. Three reasons are apparent on which this group founds its objection to the plan: (1) Aversion to federal interference with banking; (2) Distrust in the management of a central institution; (3) Antipathy to departure from the present system.

(1) Some adversaries declare themselves to be inflexibly opposed to any federal legislation further regulating the monetary and credit system. They criticize the provision of the Aldrich plan which leaves to the President of the United States the selection of the governor of the Association, evidently overlooking the great limitations on his choice. There are also opponents to the presence of members of the Cabinet and of the Comptroller of the Currency in the directorate of the Association. It is argued

that, no matter how broad-minded these men may be, they are bound to employ their positions for political ends. That these government officials could hardly resist the pressure exerted by their party to use the great influence which would come from the control of such an institution, and consequently the alliance of banking with the government would prove disastrous to both. This argument is certainly inconsistent. With only four federal representatives in a board of forty-seven directors, it is not conceivable that they can secure any substantial control of the management.

(2) Like the politicians, some business men feel that it would be almost impossible to secure an independent and incorruptible management for the central institution, and that the Association would fall under the control of some few men representing the sinister influences of Wall Street. There is little foundation for such fears. In the first place, the board of directors is large, in fact it has been argued by Mr. Morawetz* that it is too large to carry a uniform and systematic policy into effect. In the second place, in addition to the government officials included in the board, the plan provides for representation of all interests. Control or domination by special interests is therefore highly improbable. Moreover, it may well be said that one of the strongest arguments for the reforms advocated is their effect in minimizing the influence of the stock exchange on the business activities of the country.

In the course of this book it has been shown that the establishment of the Association will mean that much of the money now employed in connection with the stock exchange will be made available for business uses in all sections of the country. The vast amount of surplus funds that is now sent to Wall Street, when money is not in great demand in the interior, enables the stock exchange to carry on its

*Cited p. 132.

speculative activities regardless of the conditions in the general money market. The result is that when the money is needed for agricultural and industrial purposes, the country's available funds are tied up in securities, and can be released only through forced liquidation, often at the risk of bringing on a crisis.

The withdrawal of such surplus funds of the country from the call loan market will have a far-reaching effect upon the operations of the stock exchange and particularly upon undesirable stock booms. Wall Street will have to look elsewhere for funds to finance stock movements. It will no longer find all the money in this country, and will have to obtain part of it abroad. It will be able to secure money only when conditions in the domestic or international money markets are favorable. Thus, movements on the stock exchange will have to adjust themselves to the supply of funds properly fit for such uses, and this adjustment will be reached with little disturbance to business in general.

(3) Finally, the modern bank note secured partly by gold and partly by short-time bills, is considered as inferior to the medium of circulation now in existence in the United States. Adherents of this idea refer to the example of the Bank of England. They state that its notes are not essentially different from the circulation of the United States, both being based on the best possible security—the debt of the nation. In their opinion the English system has thoroughly vindicated itself, and they see no reason for changing the correlative American method. Still, they admit the inelasticity of the bank note circulation as a defect. They suggest to correct this disadvantage by automatically expanding and contracting the volume of circulating notes; but they fail to show any means by which that could be achieved without departing from the present system. Moreover, they evidently forget that the plan has in view larger re-

forms than the automatic regulation of the bank note currency. It aims to meet the credit needs of legitimate business in time, and not merely to provide relief in emergency. Through a constructive discount policy, it seeks to prevent overexpansion of credit and resulting crises. No institution can pretend to meet the needs of modern banking and credit, if it becomes operative only after the crisis has come, and after irreparable losses have been inflicted on the community. It is highly improbable that measures taken so late will achieve their purpose. Any projected reforms for the monetary and credit system which are limited merely to the improvement of the note system, are bound to prove inadequate.

The assertion can hardly be taken seriously that the American medium of circulation is superior to the modern bank note used on the European continent. The United States has outstanding a very large amount of paper money (\$346,700,000 in greenbacks) which is secured only in part by coin and bullion, and her bank note currency rests on practically no metallic security. In view of these circumstances we can not pretend to have a good currency system, and certainly not the best one. Both the paper money and the bank notes originated in emergencies of the Civil War, a situation not favorable to the creation of a satisfactory medium. The weakness of this monetary and credit system, both from the point of view of theory and practice, is almost universally recognized. To deny it shows a lack of clear understanding of the fundamental concepts of money and credit.

The reference to the English currency system is not at all justified. The Bank Act of 1844, now in force, has in no way stood the test. On the contrary, it has been necessary to suspend the law a number of times. This was done in 1847, 1857, and 1866. More recently, in the crises of 1890 and 1907, grave difficulties have been avoided only be-

cause the Bank of France came to the rescue of the English note institution. Is it probable that the French central bank would have been able to do so, with a note privilege similar to that of the Bank of England? Reform of the antiquated English note system is not so urgent, for London has an especially favored position in international finance as intermediary for the money and trade transactions of the world. Consequently all European central banks are interested in the solvency of England's money market and her note institution. The latter is therefore enabled to rely on foreign help whenever its currency fails. Further, the central bank is so essential a part of the English system that reference to that system by those who oppose a central institution in his country is untenable.

Practically all criticisms worthy of detailed discussion, that have been urged against the proposed legislation, are embodied in the pamphlets published by Mr. Morawetz* and Mr. Wood.† Their examinations of the Aldrich plan are thorough and their presentations of the case merit careful consideration. Therefore, we deem it advisable to give a summary of their objections, and to discuss their arguments and suggestions in detail.

Mr. Morawetz and Mr. Wood oppose a central institution, first, because they do not believe that its economic effects will be good, and second, because they agree that it would be impossible to secure the right kind of men for the executive positions.

They argue that no matter where the central office of the institution is located, its real seat will be in New York, with the result that New York will be the financial center

*The Banking and Currency Problem and its Solution. Cited p. 132.

†As to Suggested Plan for Monetary Legislation with Detailed Account of Bank of France. Cited p. 128.

of the country to an even greater extent than at present. The power of Wall Street will be strengthened. With the further concentration of the business of the nation in one place, Mr. Wood fears that foreign financial interests will find it easier to achieve their purpose and make America financially dependent, and like the rest of the world, "tributary to the North Sea and the Baltic."

They argue, furthermore, unless a central institution is managed with extreme caution and deep insight, it may become the breeding-place of very dangerous financial excesses. If such an institution should suspend payment, the result would be a financial and business panic throughout the country, vastly greater than any we have yet experienced.

The provisions of the Aldrich plan, they contend, do not solve the problem of securing as officers men fit for the position, who are above political influence and personal ambition, and it is highly improbable that such men can be found. The heterogeneous composition of the board of directors of the Association is such that it will be impossible for the members to work together harmoniously. The administration will be subject to political pressure, and it will therefore fail to win public confidence. Moreover, centralized control of banking is, in their opinion, thoroughly impractical for a country like the United States, for its vast extent renders it impossible for the officers of such an institution to familiarize themselves with the varying needs and conditions of the different sections of the country.

Mr. Morawetz and Mr. Wood both agree that there is no analogy between American and European conditions; they say, the territory in which this bank is to operate is as extensive as the aggregate area served by all the great European note banks. These institutions have been a success, because they were in harmony with national characteristics and existing bank practices; they are there deeply imbedded

in the national habits. Moreover, in Europe monetary and banking problems are free from politics. In America, however, the idea of a central bank is foreign to the country's thought and repugnant to prevailing business usages. With existing political methods it would be impossible to secure for it a business administration free from political influence. Legislation might indeed create a central financial institution, but it could neither work a revolution in present business methods nor create public confidence, and without these the Aldrich plan would be a hazardous undertaking.

Mr. Morawetz and Mr. Wood say further that it is unnecessary to take so dangerous a step. Simpler remedies are available in the existing currency associations, which can be used to expand the note circulation in times of panic. These associations are moreover in a better position to know the needs of their particular sections, and to act promptly in an emergency. They are free from political influence, and, under the guidance of an intelligent and capable Comptroller of the Currency, they could meet the need and work to great advantage. This is Mr. Wood's argument and Mr. Morawetz agrees with him in the main. The latter champions the establishment of district banks in the different industrial sections of the country. If, in spite of all, a central institution should be deemed necessary, he thinks it better that it should be preceded by the founding of district banks. These might later unite to establish a central bank and continue to exist as its branches. The duties of such an institution would be merely supervisory, great latitude being allowed to the officers and directors of the district banks.

Much of the criticism urged by these opponents of the Aldrich plan rests on political arguments. The other objections offered by them are, however, no less import-

ant. Some are just, others are not at all to the point. They make much of the argument that the chief business of a central institution would be done in New York. It does not, however, follow that this involves any grave menace. A central institution must necessarily carry on its operations chiefly in the largest money market of the country, just as the Reichsbank does in Berlin, or the Bank of France in Paris. This does not mean that these banks operate for these centers alone or even primarily for them; their activities redound to the benefit of the country as a whole. The concentration of the business of the Association in New York by no means involves a predominating influence on the part of Wall Street. The precautions embodied in the bill put this entirely out of the question. The activity of the Association in New York would have the contrary effect. It would keep in bounds the now dominating influence which Wall Street exercises in the country's finances. The membership of the Board of the Association is so constituted as to insure proper solicitude for the interests of all sections.

Greater concentration of these transactions in New York would not make it easier for European financial interests to secure control of the American situation. The whole idea of attempted European domination is chimerical, but if European bankers seriously entertained such a purpose or had the means of subjugating America financially, it is hard to see on what grounds Mr. Wood bases his belief that a decentralized banking system affords protection against European designs. The very opposite would be more probable. Small independent banks with limited means, lacking in coöperation, would evidently be easier prey for European capitalists. On the other hand, an association of the type contemplated would give the individual banks greater strength and power of resistance to foreign

aggression, and would serve to maintain the independence of American commerce and industry, if such independence were assailed.

Among other objections to a central institution, Mr. Morawetz brings up as fundamental the contention that it is a dangerous means of bringing about an inflation in the note circulation. This is an argument used many years ago in Europe by the opposition to a centralized system of issuing banknotes. Experience has shown the argument to be untenable. There is, of course, a possibility that the management of a central bank might encourage overspeculation. Where, however, reasonable precautions have been taken, such a dangerous procedure is highly unlikely. In the plan of the Association, the utmost caution has been used in devising safeguards. Whatever be the attitude toward the Association, whether we believe that in its proposed form it can achieve the ends for which it is to be established or not, one thing is certain: in devising the plan, ample precaution has been taken to prevent the institution from pursuing any but most conservative banking practices. This is made compulsory by enforcing upon the institution a very cautious discount policy. It is further insured by the safeguards with which its loan activities have been surrounded, at least under normal business conditions. If there is any ground for believing that overspeculation will be stimulated by the Association, it rests on the psychological factor noted above, namely, that the existence of an institution on which the banking system can fall back might lead some bankers or individuals to overestimate the extent to which its credit may be drawn upon. There is, on the contrary, far more likelihood of an overexpansion of credit under a decentralized system, where the banks have less sense of responsibility, and the stress of competition compels a bank to expand its

loans and go further than it would of its own accord. The history of banking bears ample evidence to this tendency.

European experience with central banks is highly illuminating in this regard, even after allowance has been made for the difference in local and foreign conditions. In their early history they, too, made mistakes, particularly the Bank of England during the first half of the last century. These institutions, however, profited by their errors, and on the basis of experience, they all adopted policies more or less similar to those outlined in the first chapter. From that time on, largely in consequence of the activity of the central banks, overspeculation in Europe has not assumed the same proportion as before. The great central banks have succeeded in moderating the violence of the recurring crises that accompany the fluctuations of industrial activity, and in minimizing their evil effects. There is no doubt that a central banking institution in the United States, built up on the experience of central banks, and pursuing their policies with such modifications as American conditions demand, would be in a position to bestow similar benefits on this country.

Mr. Morawetz and Mr. Wood certainly go too far in their contention that no analogies can be drawn from European experience. The mere difference in territorial extent is not a sufficient reason for dismissing entirely any comparison between a central institution here and the European note banks. Differences in area are certainly significant, but comparisons can be made far more profitably on the basis of economic activity, for it is the business of the country and not the extent of its territory that is the determining factor for banking. Statistical comparisons should be based, therefore, on population and on the volume of transaction rather than on square miles of area. Such an

examination shows that conditions do not differ as much as one might imagine. While the United States is indeed eighteen times the size of Germany, its population is only one and a half times as great; Germany has 65,000,000 inhabitants against America's 95,000,000. The population in Germany, gainfully employed, forms a larger percentage of the total (45.5% in 1907) than in the United States (38.4% in 1900.)* The foreign commerce of the United States is actually smaller than that of Germany.† By this is not meant that the commerce of this country, taken as a whole, is less than that of Germany, but it does indicate that conditions are not so totally incomparable. Moreover, large differences in industrial conditions for different sections are not peculiar to the United States. They have everywhere accompanied the transition period from an agricultural to an industrial stage, and they have not proved insurmountable obstacles to the success of central banks. Even today the Reichsbank is confronted by a similar situation.

Underlying business conditions in Germany and the United States are very similar,—both are primarily producing nations; both progressive; both seeking larger fields for their activities. The chief differences are easily apparent. In Germany agriculture is relatively of minor importance, and industrial activity is greatly diversified. Here, agri-

*Domestic servants and soldiers are included in this classification in the United States, but are omitted in Germany. Hence the difference is greater than appears from the figures.

†The respective figures for 1911 are:

	United States	Germany
Imports	\$1,527,200,000	\$2,330,300,000
Exports	2,049,300,000	1,952,200,000
Total.....	\$3,576,500,000	\$4,282,500,000

culture dominates the economic life, and industry is more uniform. There is not the same variety in the products of American factories; American industry is characterized by large-scale production and standardized commodities. This results in greater simplicity and creates a situation that is less complex and more readily grasped. In view of the actual complexity of the German situation, it is hard to understand how Mr. Morawetz and Mr. Wood arrive at the conclusion that European economic conditions are more favorable to the successful operation of central banks.

Mr. Morawetz and Mr. Wood are, moreover, mistaken, when they assume that national characteristics have favored centralized banking in European countries and allowed the establishment of central institutions to proceed with less opposition. Political questions have complicated banking problems there as well as in this country. It is scarcely necessary to recall the opposition of the goldsmiths—the bankers of the time—to the establishment of the Bank of England. Antagonism persisted long after the bank was founded. In Germany the idea of a central bank was vigorously fought, and the opposition, political and economic, was not overcome until the seventies. To this very day party politics is largely concerned with monetary and banking questions, and parliamentary debates are still filled with the problems of the central bank, commercial banking, the coinage, and the monetary standard. The reader may readily convince himself on this point by referring to Mr. Warburg's* treatise published by the Monetary Commission.

The arguments which Mr. Morawetz and Mr. Wood direct against the Association apply with at least equal force

*Paul M. Warburg: "The Discount System in Europe." National Monetary Commission, Document No. 402, 1910.

to their own positive or constructive propositions. They are eager to maintain a decentralized system of banking, but both seem to agree that a pure decentralization in the old form is now out of the question. Accordingly, they seek in different ways to find an agency through which some coöperation may be had among the individual banks. Mr. Wood looks to the Comptroller of the Currency, and Mr. Morawetz proposes a central institution based on district banks. Both make a concession to the idea of central banking, but the plan of neither is adequate to meet the situation. The fatal objection to decentralization is that it renders a consistent policy impossible. Mr. Morawetz proposes a central agency to exercise supervisory powers, thus influencing the policy of the individual banks. At best, however, the activities of such an agency would first come into play when it is too late, after the crisis has already reached an acute stage. Neither could the currency associations, advocated by Mr. Wood, render such valuable services as a central institution. With such agencies, there can be no thought of pursuing a discount policy intended to prevent the overexpansion of credit; their work may perhaps be remedial: it can not be preventive. In this respect they can achieve even less than the Association under the Aldrich plan.

The system proposed by Mr. Wood is notably defective, in that it leaves the small banks in a crisis entirely dependent on the good will of the larger institutions, and puts them at the mercy of their competitors. Such banks would certainly fare better with a central institution, obligated in any event to take a more disinterested attitude.

There is something inconsistent in their objections to the Association, and in their arguments for district banks or currency associations. They do not believe it possible to find the type of men needed for the management of the

National Association, but they do not solve this difficulty in the institutions proposed by them—institutions which would, in the end, perform the functions assigned to the Association in the Aldrich plan. Mr. Wood's currency associations, and Mr. Morawetz's district banks are practically no different from the contemplated branches of the National Association. If it is impossible to secure suitable managers for these branches, will not the same difficulty confront the currency associations or the district banks? Are not the officers of these institutions as likely to be affected by personal interests and political and sectional bias? If these difficulties are not unsurmountable, why prefer these institutions to the more effective agencies proposed under the Aldrich plan?

As the most serious argument against the adoption of the Association plan, Mr. Morawetz urges the extreme danger to the community involved in the mismanagement or failure of a central institution. The implication is that should a district bank be mismanaged, the results would not be so baneful. Normal conditions would continue elsewhere and other district banks could be called upon to assist in the emergency. With a central bank, the entire country would be imperiled. This view seems repugnant. There is more likelihood that, with each district bank pursuing its own policy, a period of business expansion would find many, if not all of the district institutions with overextended credit. Under such a system there is grave danger that the most dreaded evils of decentralization will be realized. In a crisis, not one, but many district banks may be involved, and the collapse of any one would carry the others down with it. The outcome would be no less disastrous than suspension of payment by a central bank.

If we take the other alternative and deny a large measure of freedom to the separate banks, we lose elasticity in the

monetary and credit system and do not arrive at any improvement over the existing situation.

Under the Aldrich plan, on the other hand, it can not be doubted that we would have coördination and coöperation. The branches of the Association would be fully as conversant with the needs of their localities as the suggested district banks or currency associations. Through them the central institution can keep itself informed of the entire situation. With it would rest the final decision as also the formulation and enforcement of a consistent policy.

The presence in its directorate of representatives of all interests will be no disadvantage. On the contrary, it will afford a common meeting-ground where the claims of conflicting interests can be harmonized, and the way paved for the adoption of a conservative policy. If indeed the Association were ever endangered through some mistake in policy, assistance would in all probability be promptly forthcoming from abroad, as all the great central banks feel the need of coöperation. Under a decentralized system there is little hope of securing help from foreign sources. With a large number of independent banks, it is far more difficult to take such a step promptly and effectively than when there is a central bank.

If currency associations or district banks are adopted, there is nothing to prove that they will be free from political pressure. The most exacting care, we are told, will not suffice to keep the men in the leading positions free from such influences. There is danger that political influences will creep in through the various local institutions and extend to the projected central agency for district banks, or even to the Comptroller of the Currency, who is to be entrusted with certain powers over the currency associations, and with the right to a final decision in matters pertaining to them.

In the Aldrich plan, the composition of the directorate, both in the local and central institutions, is such as to insure the elimination of political influence in a great measure. It is true that no precaution can suffice where the spirit is wanting, and where men will not give their disinterested services to further the public welfare. The deliberate abuse of office on the part of those in authority is not charged by any of the opponents of the proposed Association. Mr. Morawetz and Mr. Wood assert emphatically that there are no grounds for doubting the integrity and the capacity of the leading American statesmen and bankers. Nevertheless, they believe that they would be incapable of faithfully performing the parts assigned to them under the Aldrich plan, as they would find themselves unable to resist the temptation of shaping the policy of the institution so as to serve their own selfish purposes. If it be true that men of honor cannot remain free from unselfishness and partisanship in the administration of the affairs of such an institution, then the hope of a central note bank, devoted solely to the interest of the general public, might as well be abandoned. European experience, however, contradicts this pessimism. As Mr. Morawetz and Mr. Wood testify, it has always been possible there to find in abundance men worthy of office,—men who have acquitted themselves honorably and well. It would seem reasonable to suppose that what has been possible in European countries might also be realized in America, and that men patriotic enough to subordinate all interests to the advancement of the country's welfare, will be forthcoming. It may indeed prove harder to find these men here than in Europe, with its older traditions, where public office confers greater distinction. It is incredible, however, that the United States should find it impossible to establish a central banking institution for lack of men to administer its affairs unselfishly and wholly for the public good.

In the foregoing pages there have been presented the views and opinions of the opposition to the Aldrich plan both for political reasons and on the ground of banking needs. However, among financial authorities the plan has found more advocates than opponents.

It was received with practical unanimity at the New Orleans Bankers' Convention, where the best known American banking experts were assembled. This approval does not imply that in their opinion the plan is perfect, and that there is no need for any change or amendment. These men had in mind the idea that the plan represented a step toward a more perfect system. The convention sought to impress upon the public the importance of the reforms proposed.

For the same reasons many of the leaders in banking openly expressed their approval of the Aldrich plan, in reply to a circular of inquiry sent out by the "New York Evening Post." That view is best stated in the answer of Mr. Lacy:* "My attitude toward the Aldrich currency plan is entirely friendly, believing as I do that it is a great step towards obtaining a sounder and more scientific banking system. I look upon the Aldrich plan, however, as largely a makeshift—the best that we can hope to obtain under present conditions, and with the popular mind in the attitude that it is at this time. While it is an extremely ingenious plan, it is very crude when compared with the more highly developed systems of other nations, but its framer has, I think, been very wise in attempting to go no farther than he has, as we must take into consideration popular views and prejudices on this question."

After all it is certain that the establishment of the

* Graham G. Lacy, Vice-President Tootle-Lemon National Bank, St. Joseph, Mo., in the New York Evening Post—Annual Financial Review Past and Future—Dec. 30, 1911: "What Men at the Head of the Banks Expect During 1912."

National Reserve Association would bring about a vast improvement in the American monetary and credit system. We may, however, feel sure that before long it will become very clear that the plan must be modified and supplemented in important details. The organization of the N. R. A. will have to be made comparable with that of the great European central banks, before Mr. Forgan's* hopes can be realized and the Association become "the largest, the strongest, the safest and the best financial institution in the world," and before it can "put our banking and currency system where it should be: in the front rank of those of the leading nations of the world."

*Forgan: Mobilization of Reserves etc.; cit. p. 15.

C. Conclusion

Under present conditions, we can not look forward to the establishment of a central institution for the issue of circulating notes which should meet all the requirements of an ideal banking system. The question is, whether the establishment of the National Reserve Association is none the less worth while. Some advocates of a central bank take the position that the existing banking system should not be disturbed until complete reform can be achieved. Such an attitude is not commendable. The Aldrich plan is a significant step, if for no other reason, because it creates an institution to demonstrate practically the importance and necessity of the reforms advocated.

This contention is valid, even though the plan contains a number of weak points, and modifications in several respects are highly desirable. Whether such changes are made and the powers of the Association amplified or not, so much is certain:—the enactment of the proposed legislation will at least mean the beginning of improved conditions in more than one direction. It will place our monetary and credit system on a more secure foundation than ever before. It will make possible the employment of the country's financial resources to much greater advantage, and a more equitable distribution of our available capital among the different sections and industries of the nation. It will raise the importance and influence of the United States among the financial powers of the world!

The establishment of the Association, the reorganization of our system of note issue so as to bring it into correlation

with the movements of business, and finally the concentration of the nation's cash reserve in one central agency, are reforms that will serve to create a strong support for our banks, and for the credit system of the country. The banks will feel sure of their ability to secure help from the central agency in the money stringencies that arise in the course of the year, and also on the urgent occasions of financial crises. They will, therefore, not find it necessary to withdraw cash from circulation and use in business, and to restrict credits on the first signs of disturbance.

Relying on the Association to meet the need for additional currency, the banks will be able to give all their energies to the situation confronting them. They will feel free to extend help to reliable business men, and to carry them through the emergency. The country will thus be spared at least some of the evils accompanying crises. The banks will not hesitate to pay out their cash freely to frightened depositors, and, thereby, to put an end to a run before it assumes large proportions, and spreads to other institutions. With the credit organization strengthened, we may justly hope to guard against a general loss of confidence in the banks, and either to allay distrust altogether, or to restrict it to the particular locality in which it originates. One of the chief causes of panics will thus be removed, and the business of the country saved from these destructive visitations.

By taking over the work of the United States Treasury the Association will be able to manage the collection of revenues and the disbursements of the government without occasioning the present disturbance to business in general.

Finally, the organization of the N. R. A. will provide the essential condition for the development of a far-reaching market for short-time loans and discounts. As has been explained in detail, it will make possible a general and an open

money market. Such money markets will bring notable advantages to the United States, both in its domestic and in its foreign trade. The effects will prove beneficent alike to all sections of the country and to all branches of business.

As soon as the banks are enabled to rediscount bills and to obtain from a central institution currency in exchange for their commercial paper, the paper of merchants and manufacturers will become the most desirable form of investment for funds which banks must be ready to repay on demand. European experience will be repeated here. A market will develop for short time loans, where surplus funds from all parts of the country will come for investment, and where the demand for money from all lines of business will find expression in bills offered for discount. Through this open market use will be found quickly for the surplus funds of any district or industry, making them available to other sections of the country or branches of business in need of capital. The financial resources of the United States will thereby be utilized to the fullest extent and for the greatest good.

The organization of an open money market will have the effect of freeing the producers of our staple commodities, and particularly our exporters, from dependence on European banks. Supported by a central agency like the Association, and enjoying the facilities of a market for short-time loans, American banks will be able to perform for the commerce of the country the work now done by the foreign banks. They will, moreover, find their task much facilitated, if American banks are also established abroad, as the Aldrich plan contemplates.

A strong and highly perfected money market in the United States must necessarily occupy a position of permanent influence in the international money centers of the

world. This influence the American money market will be able to exert abroad in the interests of this country. Whenever the price of money at home is higher than abroad, it should prove easy to send American bills abroad, and import European capital. On the other hand, whenever there is a superabundance of money here, it will be possible to take advantage of the higher interest rate of Europe more readily than today. All the conditions will be present for utilizing to the advantage of the United States any differences between the rate of interest here and in the money centers of Europe. America will thus help in bringing about the most profitable distribution of the world's floating capital. At the same time, it will strengthen its own financial position among the money powers of the world.

The National Reserve Association will tend to give greater dignity and importance to the American credit system. A national money market at home will make us able to reorganize our financial system, so that we shall no longer be a constant menace to the money markets of Europe. On the contrary, a point may be reached where we shall give help to other markets, when occasion demands. In turn we shall be able to call on foreign money markets to assist us in time of need. This would mean for America, not a position of financial subordination, but one of international coöperation to the mutual advantage of all. The benefits would not be confined to those immediately interested, but would extend to all business activities, and make for marked improvement in international credit.

The advantages which the state might derive from an institution such as the National Reserve Association are abundantly demonstrated by history. Mention need only be made of the work of the Bank of France in 1870, when it not only proved the financial mainstay, but actually saved France. In establishing an institution like the National Reserve As-

sociation, there is naturally no thought of such an emergency. Nevertheless, a great central institution administered in the interest of the general welfare and enjoying the full confidence of all classes adds to the nation's sense of confidence. It is better prepared for emergencies, in having an agency through which it can appeal for the financial support of the nation, and marshal the economic resources of the people for the needs of the state.

Should the Association be established in the form now advocated, it will be able in spite of the limitations on its powers to do much towards achieving the ends for which it is proposed. In carrying on its work and more particularly in any effort to guide or restrain the movements in the money market, it will undoubtedly find itself much hampered by the restrictions on its activity, especially on its discount operations. There is, therefore, some ground for the fears of those who advocate a central bank, believing that the limitations on the freedom of the Association may in the end nullify its powers for good. We should seriously consider whether unnecessary restraints have not been put on the Association, and whether it would not be desirable to relax some of the restrictions, and to extend the scope of its powers at the outset.

However, even if this is not done, and the Association is organized in the form and with the limitations now proposed, we may be sure that if it justifies the hopes of its sponsors, even in part, and succeeds in winning the confidence of all, irrespective of political affiliations, it will in the course of time evolve into a general central bank and secure the extension of power necessary for the adequate discharge of its functions. The contemplated legislation fortunately provides for modifications and amendments. As the President says in his message: "It will always be

possible, of course, to correct any features of the new law which may in practice prove unwise; so while this law is sure to be enacted under conditions of unusual knowledge and authority it also will include, it is well to remember, the possibility of future amendment."

In leaving it open to Congress to amend and modify the law regulating the Association, an additional safeguard is introduced against abuses which may develop in the Association, but which can not now be foreseen. It should be said again in conclusion that there is little basis for the chief argument urged in opposition to the Aldrich plan—the danger that the Association may be misused for political purposes, or be subservient to the selfish interests of any section or financial coterie. The precautions taken to prevent the control of the Association by political or financial cliques have been devised with great skill, and there is every reason to believe that they will prove effective. The provisions embodying them constitute the best planned and most carefully thought out features of the bill now before Congress.

Incomprehensible is the fear, so frequently expressed by the opponents of the Aldrich plan, that it will be impossible to find proper men to direct the Association. It is hard to follow the reasoning that would reject the entire scheme of banking reform on such vague and unfounded apprehensions. Moreover, there is no choice. Reform is inevitable, if we are to make progress and avoid disastrous panics. Whatever be the specific features of a plan of a reform, the fundamental lines of development have been definitely set by the teachings of history and experience. The goal must be centralization in one form or another. We agree with Mr. Roberts, the Director of the Mint,* that "It will not do to say that necessary powers must not be created because they may be abused . . . We

*"The Next Reform—Banking," cited p. 23.

have to rely to some extent upon our capacity for self-government in the future. We have to believe that we can do what we must, in order to assure our progress as a people. To say that we can not manage a system, the essential principle of which is in successful operation in every other country of the world, is a serious reflection upon the intelligence of the American people and on their moral capacity to do business by the most advanced methods."

APPENDIX

A. The Bill

Index

Organization

Charter, capital and location	1-2*
Membership	3
Organization committee	4
Branches	5
Districts	5
Local associations	6
Directors of local associations	7
Directors of branches	8
Directors of the Association	9
Executive officers of the Association	10
Payment for shares	11
Increase and decrease of the capital	12
Taxation	13
Committees of the Association	14
Board of examination	15
Managers and committees of the branches	16
Presidents and executive committee of the local associations	17
List of the shareholders	18
Earnings and dividends	19

* The figures indicate sections of the bill.

Functions of the Local Associations

Guaranty of commercial paper	20
Clearing house; domestic exchange	21
Privileges and membership	22

Functions of the National Reserve Association

Fiscal agent for the United States	23
Deposits	24
Interest on deposits	25
Discount of notes and bills of exchange	26-27
Discount of direct obligations of banks	28
Functions of the branches	29
Rates of discount	30
Bank acceptances	31
Purchase of prime bills	32
Purchase of bonds and obligations	33
Gold transactions	34
Foreign checks or bills of exchange	35
Bank accounts and agencies in foreign countries..	36
Domestic exchange	37
Real estate	38

Reserves and Reports

Reserves of subscribing banks	39
Loans upon real estate	40
Reserves of the Association	41-42
Reports by the Association	43
Reports by subscribing banks	44-46

Note Issue and United States Bonds

National banks and government bonds	47
Note circulation of national banks	48
Two per cent United States bonds and redemption of notes of the national banks	49

INDEX

181

Reserves for note issue of the Association	50
Special tax on note issue	51
First lien and redemption	52
Legal tender	53
Forwarding of notes	54
Three per cent United States bonds	55
Special franchise tax	56
 Banking Corporations for Foreign Countries	 57
Provision for Amendments	58

A Bill

To Incorporate the National Reserve Association of the United States, and for Other Purposes

Italics indicate alterations from or additions to "Suggested Plan for Monetary Legislation. Revised Edition." Parentheses refer to sections of the "Revised Edition."

Organization

Charter, Capital and Location.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the National Reserve Association of the United States be, and it is hereby, created and established for a term of fifty years from the date of filing with the Comptroller of the Currency a certificate of paid-in capital stock as hereinafter provided. It shall have an authorized capital equal in amount to twenty per centum of the paid-in and unimpaired capital of all banks eligible for membership in said National Reserve Association. Before said association shall be authorized to commence business two hundred million dollars of the capital stock shall be subscribed and one hundred million dollars of its capital shall be paid in cash. The capital stock of said association shall be divided into shares of one hundred dollars each. The outstanding capital stock may be increased from time to time as subscribing banks increase their capital or as additional banks become subscribers or may be decreased as subscribing banks reduce their capital or leave the association by liquidation. The head office of the National Reserve Association shall be located at Washington, in the District of Columbia. (P.1.)

SEC. 2. *Upon duly making and filing with the Comptroller of the Currency the certificate hereinafter required the National Reserve Association of the United States shall become a body corporate and as such and by that name shall have power—*

First. To adopt and use a corporate seal.

Second. To have succession for a period of fifty years from the date of said certificate.

Third. To make all contracts necessary and proper to carry out the purposes of this act.

Fourth. To sue and be sued, complain and defend, in any court of law or equity, as fully as natural persons.

Fifth. To elect or appoint directors and officers in the manner hereinafter provided and define their duties.

Sixth. To adopt by its board of directors by-laws not inconsistent with this act, regulating the manner in which its property shall be transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To purchase, acquire, hold, and convey real estate as hereinafter provided.

Eighth. To exercise by its board of directors or duly authorized committees, officers, or agents, subject to law, all the powers and privileges conferred upon the National Reserve Association by this act. (No corresponding provisions).

SEC. 3. All national banks, and all banks or trust companies chartered by the laws of any State of the United States or of the District of Columbia, complying with the requirements for membership in the said National Reserve Association, hereinafter set forth may subscribe to its capital to an amount equal to twenty per centum of the paid-in and unimpaired capital of the subscribing bank, and *not more nor less*; and each of such subscribing banks shall become a member of a local association as hereinafter provided. Fifty per centum of the subscriptions to the capital stock of the National Reserve Association shall be fully paid in; the remainder of the subscriptions or any part thereof shall become a liability of the subscribers subject to call and payment thereof whenever necessary *to meet the obligations of the National Reserve Association under such terms and in accordance with such regulations as the board of directors of the National Reserve Association may prescribe.* (P. 2.)

Membership

The subscriptions of a bank or trust company incorporated under the laws of any State or of the District of Columbia to the capital stock of the National Reserve Association shall be made subject to the following conditions: (P. 60.)

First. That (a) if a bank, it shall have a paid-in and unimpaired capital of not less than that required for a national bank in the same locality; and that (b) if a trust company, it shall have an unimpaired surplus of not less than twenty per centum of its capital, and if located in a place having a population of *six thousand inhabitants or less shall have a paid-in and unimpaired capital of not less than fifty thousand dollars; if located in a city having a population of more than six thousand inhabitants and not more than fifty thousand inhabitants, shall have a paid-in and unimpaired capital of not less than one hundred thousand dollars; if located in a city having a population of more than fifty thousand inhabitants and not more than two hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than two hundred thousand dollars; if located in a city having a population of more than two hundred thousand inhabitants and not more than three hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than three hundred thousand dollars; if located in a city having a population of more than three hundred thousand inhabitants and not more than four hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than four hundred thousand dollars, and if located in a city having a population of more than four hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than five hundred thousand dollars.* (P. 61.)

Second. That it shall have and agree to maintain against its demand deposits a reserve of like character and proportion to that required by law of a national bank in the same locality: Provided, however, That deposits which it may have with any subscribing national bank, State bank, or trust company in a city designated in the national banking laws as a reserve city or a central reserve city shall count as reserve in like manner and to the same extent as similar deposits of a national bank with national banks in such cities. (P. 62)

Third. That it shall have and agree to maintain against other classes of deposits the percentages of reserve required by this act. (P. 63)

Fourth. That it shall agree to submit to such examinations and to make such reports as are required by law and to comply with the requirements and conditions imposed by this act and regulations made in conformity therewith. (P. 64)

The words "subscribing banks" when used hereafter in this act shall be understood to refer to such national banks, and banks or trust companies chartered by the laws of any State of the United States or of the District of Columbia, as shall comply with the requirements for membership herein defined. (P. 2)

SEC. 4. *The Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency are hereby designated a committee to effect the organization of the National Reserve Association, and the necessary expenses of said committee shall be payable out of the Treasury upon vouchers approved by the members of said committee, and the Treasury shall be reimbursed by the National Reserve Association to the full amount paid out therefor.*

Organization
Committee

Within sixty days after the passage of this act said committee shall provide for the opening of books for subscriptions to the capital stock of said National Reserve Association in such places as the said committee may designate. Before the subscription of any bank to the capital stock of the National Reserve Association shall be accepted, said

bank shall file with the organization committee or after organization with the National Reserve Association a certified copy of a resolution adopted by the board of directors of said bank accepting all the provisions and liabilities imposed by this act and authorizing the president or cashier of said bank to subscribe for said stock. (P. 28)

Branches

SEC. 5. When the subscriptions to the capital stock of the National Reserve Association shall amount to the sum of two hundred million dollars the organization committee hereinbefore provided shall forthwith proceed to select fifteen cities in the United States for the location of the branches of said National Reserve Association: *Provided, That one branch shall be located in the New England States, including the States of Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut; two branches in the Eastern States, including the States of New York, New Jersey, Pennsylvania, and Delaware; four branches in the Southern States, including the States of Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, Texas, Arkansas, Kentucky, Tennessee, and also the District of Columbia; four branches in the Middle Western States, including the States of Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, and Missouri; four branches in the Western and Pacific States, including the States of North Dakota, South Dakota, Nebraska, Kansas, Montana, Wyoming, Colorado, New Mexico, Oklahoma, Washington, Oregon, California, Idaho, Utah, Nevada, and Arizona.*

Districts

When the cities in which the branches are to be located have been selected the organization committee shall forthwith divide the entire country into fifteen districts, with one branch of the National Reserve Association in each district: *Provided, That the districts shall be apportioned with due regard to the convenient and customary course of business and not necessarily along State lines.*

The districts may be readjusted, and new districts and new branches may from time to time be created by the directors of the National Reserve Association whenever, in their opinion, the business of the country requires. (P.6)

Local Associations

SEC. 6. All subscribing banks within a district shall be grouped by the organization committee or after organization, by the National Reserve Association, into local associations of not less than ten banks, with an aggregate capital and surplus of at least five million dollars, for the purposes hereinafter prescribed: *Provided, That the territory included in each association shall be contiguous and that in apportioning the territory due regard shall be had for the customary course of business and for the convenience of the banks forming the association: Provided further, That in apportioning the territory to local associations comprising a district every bank and all of the territory within said district shall be located within the boundaries of some local association: And provided further, That every subscribing bank shall become a member only of the local association of the territory in which it is situated.*

The banks uniting to form a local association shall, by their presidents or vice presidents, under authority from the board of directors, execute a certificate in triplicate setting forth the name of the association, the names of the banks composing it, its principal place of business, its territorial limits, and the purposes for which it is organized. One copy of this certificate shall be filed with the Comptroller of the Currency, one copy shall be filed with the National Reserve Association, and one copy shall be filed with the branch of the National Reserve Association of the district in which the local association is included. Upon the filing of such certificates the local association therein named shall become a body corporate and by the name so designated may sue and be sued and exercise the powers of a body corporate for the purposes mentioned in this act, and not otherwise.

The local associations in each district may be readjusted from time to time and new associations may be authorized by the directors of the National Reserve Association. (P.5)

SEC. 7. Each local association shall have a board of directors, the number to be determined by the by-laws of the local association. Three-fifths of that number shall be elected by ballot cast by the representatives of the banks that are members of the local association, each bank having one representative and each representative one vote for each of the positions to be filled without reference to the number of shares which the bank holds in the National Reserve Association. Two-fifths of the whole number of directors of the local association shall be elected by the same representatives of the several banks that are members of the association, but in voting for these additional directors each representative shall be entitled to as many votes as the bank which he represents holds shares in the

Directors of Local Associations

National Reserve Association: *Provided, That in case forty per centum of the capital stock in any subscribing bank is owned directly or indirectly by any other subscribing bank, or in case forty per centum of the capital stock in each of two or more subscribing banks, being members of the same local association, is owned directly or indirectly by the same person, persons, copartnership, voluntary association, trustee, or corporation, then and in either of such cases, neither of such banks shall be entitled to vote separately, as a unit, or upon its stock, except that such banks acting together, as one unit, shall be entitled to one vote, for the election of the board of directors of such local association. In no case shall voting by proxy be allowed. The authorized representative of a bank, as herein provided, shall be its president, vice president, or cashier.*

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this act.

The directors originally elected shall hold office until the second Tuesday in February immediately following their election, and thereafter the directors shall be elected annually on that date and shall hold office for the term of one year. (P. 8)

The board of directors of the local association shall have authority to make by-laws, not inconsistent with law, which shall be subject to the approval of the National Reserve Association. (P. 28)

SEC. 8. Each of the branches of the National Reserve Association shall have a board of directors, the number, not less than twelve in addition to the ex officio member, to be fixed by the by-laws of the branch. These directors shall be elected in the following manner:

Directors of
Branches

The board of directors of each local association shall elect by ballot a voting representative. One-half of the elected directors of the branch shall be elected by the vote of such representatives, each representative having one vote for each of the positions to be filled, without reference to the number of shares which the banks composing the association which he represents holds in the National Reserve Association. One-third of the elected directors shall be elected by the same voting representatives, but each voting representative in this case shall have a number of votes equal to the number of shares in the National Reserve Association held by all the banks composing the local association which he represents. The remaining one-sixth of the directors shall be chosen by the directors already elected and shall fairly represent the agricultural, commercial, industrial, and other interests of the district and shall not be officers nor, while serving, directors of banks, trust companies, insurance companies, or other financial institutions. The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board.

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this act.

All the members of the board of directors of the branch except the ex officio member shall at the first meeting of the board be divided into three classes. One-third of the directors shall hold office until the first Tuesday in March immediately following the election; one-third of the directors shall hold office for an additional period of one year after the first Tuesday in March immediately following the election; the remaining one-third of the directors shall hold office for an additional period of two years after the first Tuesday in March immediately following the election. All elections shall be held on the first Tuesday in March of each year, and after the first election all directors shall be elected for a term of three years: *Provided, That the by-laws of the National Reserve Association shall provide for the manner of filling any vacancies which may occur in the board of directors of the branches. (P. 9, 10, 11, 12 and 13)*

The board of directors of the branch shall have authority to make by-laws, not inconsistent with law, which shall be subject to the approval of the National Reserve Association. (P. 28)

SEC. 9. The National Reserve Association shall have a board of directors, to be chosen in the following manner:

Directors of
the N. R. A.

First. Fifteen directors shall be elected, one by the board of directors of each branch of the National Reserve Association. In case the number of districts shall be increased hereafter, each additional district shall be entitled to elect an additional director of this class.

Second. *Fifteen additional directors shall be elected, one by the board of directors of each branch of the National Reserve Association, who shall fairly represent the agricultural, commercial, industrial, and other interests of the district, and who shall not be officers nor, while serving, directors of banks, trust companies, insurance companies, or other financial institutions. In case the number of districts shall be increased hereafter, each additional district shall be entitled to elect an additional director of this class.*

Third. *Nine additional directors shall be elected by voting representatives chosen by the boards of directors of the various branches, each of whom shall cast a number of votes equal to the number of shares in the National Reserve Association held by the banks in the branch which he represents. Not more than one of the directors of this class shall be chosen from one district. Directors of each of the three classes named above shall be residents of the district from which they are elected.*

Fourth. *There shall be seven ex officio members of the board of directors, namely: The governor of the National Reserve Association, who shall be chairman of the board, two deputy governors of the National Reserve Association, the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency.*

No member of any national or State legislative body shall be a director of the National Reserve Association, nor any of its branches, nor of any local association.

All the members of the board, except the ex officio members, shall at the first meeting of the board be divided into three classes. One-third of the directors shall hold office until the first Tuesday in April immediately following the election; one-third of the directors shall hold office for an additional period of one year after the first Tuesday in April immediately following the election; the remaining one-third of the directors shall hold office for an additional period of two years after the first Tuesday in April immediately following the election. All elections shall be held on the first Tuesday in April of each year, and after the first election all directors shall be elected for a term of three years: Provided, That all directors provided for in sections seven, eight, and nine of this Act shall serve until their successors have qualified: And provided further, that the by-laws of the National Reserve Association shall provide for the manner of filling any vacancies which may occur in the board of directors of the National Reserve Association.

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this Act.

The board of directors of the National Reserve Association shall have authority to make by-laws, not inconsistent with law, which shall prescribe the manner in which the business of said association shall be conducted and the privileges granted to it by law exercised and enjoyed. (P. 14, 15, 16, 17, 18, 19, 20, and 28)

SEC. 10. *The executive officers of the National Reserve Association shall consist of a governor, two deputy governors, a secretary, and such subordinate officers as may be provided by the by-laws. The governor of the National Reserve Association shall be selected by the President of the United States from a list of not less than three submitted to him by the board of directors of said association. The person so selected shall thereupon be appointed by the said board as governor of the National Reserve Association for a term of ten years, subject to removal for cause by a two-thirds vote of the board. There shall be two deputy governors, to be elected by the board, for a term of seven years, subject to removal for cause by a majority vote of the board. The two deputy governors first elected shall serve for terms of four years and seven years, respectively. In case of any vacancy in the office of deputy governor his successor shall be elected to fill the unexpired term. In the absence of the governor or his inability to act, the deputy who is senior in point of service shall act as governor. The board of directors shall have authority to appoint such other officers as may be provided for by the by-laws. (P. 24)*

SEC. 11. *When the National Reserve Association is duly organized its board of directors shall call upon the subscribing banks for a payment of fifty per centum on the amount of their subscriptions to the capital stock of said association. When one hundred million dollars of capital have been paid in the board of directors shall at once proceed to execute and file with the Secretary of State a certificate showing the payment of one hundred million dollars on capital stock, and they shall further file with the Comptroller of the Currency a certificate showing the title and location of each bank which has subscribed to the*

Executive
Officers of
the N. R. A.

Payment for
Shares

capital stock of the National Reserve Association, the number of shares subscribed by each, and the amount paid thereon. (No corresponding provisions.)

SEC. 12. Shares of the capital stock of the National Reserve Association shall not be transferable, and under no circumstances shall they be *hypothecated* nor shall they be owned otherwise than by subscribing banks, nor shall they be owned by any such bank other than in the proportion herein provided. In case a subscribing bank increases its capital it shall thereupon subscribe for an additional amount of the capital of the National Reserve Association equal to twenty per centum of the bank's increase of capital, paying therefor its then book value as shown by the last published statement of said association. A bank applying for membership in the National Reserve Association at any time after its formation must subscribe for an amount of the capital of said association equal to twenty per centum of the capital of said subscribing bank, paying therefor its then book value as shown by the last published statement of said association. *When the capital of the National Reserve Association has been increased either on account of the increase of capital of the banks in said association or on account of the increase in the membership of said association, the board of directors shall make and execute a certificate showing said increase in capital, the amount paid in and by whom paid. This certificate shall be filed in the office of the Comptroller of the Currency.* In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said association, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said association. In either case the shares surrendered shall be canceled and the bank shall receive in payment therefor a sum equal to their then book value as shown by the last published statement of said association.

Increase and
Decrease of
Capital

If any member of the National Reserve Association shall become insolvent and a receiver be appointed, the stock held by it in said association shall be cancelled and the balance, after paying all debts due by such insolvent bank to said association (such debts being hereby declared to be a first lien upon the paid-in capital stock), shall be paid to the receiver of the insolvent bank.

Whenever the capital stock of the National Reserve Association is reduced, either on account of the reduction in capital of members of said association or the liquidation or insolvency of any member, the board of directors shall make and execute a certificate showing such a reduction of capital stock and the amount repaid to each bank. This certificate shall be filed in the office of the Comptroller of Currency. (P. 3)

SEC. 13. The National Reserve Association and its branches and the local associations shall be exempt from local and State taxation except in respect to taxes upon real estate. (P. 7)

Taxation

SEC. 14. The directors of the National Reserve Association shall annually elect from their number an executive committee and such other committees as the by-laws of the National Reserve Association may provide. The executive committee shall consist of nine members, of which the governor of the National Reserve Association shall be ex officio chairman and the two deputy governors and the Comptroller of the Currency ex officio members, but not more than one of the elected members shall be chosen from any one district. (P. 21)

Committees of
the N. R. A.

The executive committee shall have all the authority which is vested in the board of directors, *except the power of nomination, appointment, and removal of the governor and deputy governors* and except such as may be specifically delegated by the board to other committees or to the executive officers, or such as may be specifically reserved or retained by the board. (P. 22)

SEC. 15. There shall be a board of examination elected annually by the board of directors from among their number, *excluding the members of the executive committee*, of which the Secretary of the Treasury shall be ex officio chairman. *It shall be the duty of this board to carefully examine the condition and the business of the National Reserve Association and of its branches and to make a public statement of the result of such examination at least once a year.* (P. 23)

Board of
Examination

SEC. 16. Each branch shall have a manager and a deputy manager appointed from the district by the governor of the National Reserve Association with the approval of the executive committee of said association *and the board of directors of the branch*, and subject to removal at any time by the governor with the approval of the executive committee of the National Reserve Association. The powers and duties of the manager and deputy manager

Managers and
Committees of
the Branches

and of the various committees of the branches shall be prescribed by the by-laws of the National Reserve Association. (P. 25 and 26)

President and
Executive
Committee

SEC. 17. The directors of each local association shall annually elect from their number a president, a vice president, and an executive committee, whose powers and duties shall be determined by the by-laws of the local association, subject, however, to the approval of the National Reserve Association. (P. 27)

List of the
Shareholders

SEC. 18. *The National Reserve Association shall cause to be kept at all times, at the head office of the association, a full and correct list of the names of the banks owning stock in the association and the number of shares held by each. Such list shall be subject to the inspection of all the shareholders of the association, and a copy thereof on the first Monday of July of each year shall be transmitted to the Comptroller of the Currency. (No corresponding provisions.)*

Earnings and
Dividends

SEC. 19. The earnings of the National Reserve Association shall be disposed of in the following manner:

After the payment of all expenses and the franchise and other taxes not provided for in this section the shareholders shall be entitled to receive an annual dividend of four per centum on the paid-in capital, which dividend shall be cumulative. Further annual net earnings shall be disposed of as follows: First, *a contingent fund shall be created, which shall be maintained at an amount equal to one per centum on the paid-in capital, and shall not exceed in any event two million dollars and shall be used to meet any possible losses. Such funds shall, upon the final dissolution of the National Reserve Association, be paid to the United States and shall not under any circumstances be included in the book value of the stock or be paid to the shareholders.* Second, one-half of additional net earnings shall be paid into the surplus fund of the National Reserve Association until said fund shall amount to twenty per centum of the paid-in capital, one-fourth shall be paid to the United States as a franchise tax, and one-fourth shall be paid to the shareholders, until the shareholders' dividend shall amount to five per centum per annum on the paid-in capital: *Provided*, That no such dividends, exclusive of the cumulative dividends above provided for, shall at any time be paid in excess of five per centum in any one year. Whenever and so long as the contingent fund has been provided for and the five per centum dividend has been paid to shareholders one-half of the additional earnings shall be added to the surplus fund, and one-half shall be paid to the United States as a franchise tax. Whenever and so long as the surplus fund of the National Reserve Association amounts to twenty per centum of the paid-in capital and the shareholders shall have received dividends not exceeding five per centum, all excess earnings shall be paid to the United States as a franchise tax. (P. 4)

FUNCTIONS OF THE LOCAL ASSOCIATIONS

Guaranty of
Commercial
Paper

SEC. 20. Any member of a local association may apply to such association for a guaranty of the commercial paper which it desires to rediscount at the branch of the National Reserve Association in its district. Any such bank receiving a guaranty from a local association shall pay a commission to the local association, to be fixed in each case by its board of directors. Expenses and losses in excess of commissions shall be met by an assessment of the members of the local association in proportion to the ratio which their capital and surplus bears to the aggregate capital and surplus of the members of the local association, which assessment shall be made by its board of directors, and the commission received for such guaranty, after the payment of expenses and possible losses, shall be distributed among the several banks of the local association in the same proportion. A local association shall have authority to require security from any bank offering paper for guaranty, or it may decline to grant the application. The total amount of guaranties by a local association to the National Reserve Association shall not at any time exceed the aggregate capital and surplus of the banks forming the guaranteeing association. (P. 29 and 30)

Clearing
House;
Domestic
Exchange

SEC. 21. Any local association may by a vote of three-fourths of its members and with the approval of the National Reserve Association, assume and exercise such of the powers and functions of a clearing house as are not inconsistent with the purposes of this act. The National Reserve Association may require any local association to perform

such services in facilitating the domestic exchanges of the National Reserve Association as the public interests may require. (P. 31)

SEC. 22. All of the privileges and advantages of the National Reserve Association shall be equitably extended to every bank of any of the classes herein defined which shall subscribe to its proportion of the capital stock of the National Reserve Association and shall otherwise conform to the requirements of this act: Provided, That the *National Reserve Association* may suspend a bank from the privileges of membership for refusal to comply with such requirements or for a failure for thirty days to maintain its reserves, or to make the reports required by this act, or for misrepresentation in any report or examination as to its condition or as to the character or extent of its assets or liabilities. (P. 33 and 34)

Privileges and
Membership

FUNCTIONS OF THE N. R. A.

SEC. 23. The National Reserve Association shall be the principal fiscal agent of the United States. The Government of the United States shall upon the organization of the National Reserve Association deposit its general funds with said association and its branches, and thereafter all receipts of the Government, *exclusive of trust funds*, shall be deposited with said Association and its branches, and all disbursements by the Government shall be made through said association and its branches. (P. 36 and 1)

Fiscal Agent
for the U. S.

SEC. 24. The Government of the United States and banks owning stock in the National Reserve Association shall be the only depositors in said association. All domestic transactions of the National Reserve Association shall be confined to the Government and the subscribing banks, with the exception of the purchase or sale of Government or State securities or securities of foreign governments or of gold coin or bullion. (P. 35)

Deposits

SEC. 25. The National Reserve Association shall pay no interest on deposits. (P. 37)

Interest on
Deposits

SEC. 26. The National Reserve Association may *through a branch* rediscount for and with the indorsement of any bank having a deposit with it, notes and bills of exchange arising out of commercial transactions; that is, notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, and not including notes or bills issued or drawn for the purpose of carrying stocks, bonds, or other investment securities.

Discount of
Notes and
Bills of
Exchange

Such notes and bills must have a maturity of not more than twenty-eight days, and must have been made at least thirty days prior to the date of rediscount. The amount so rediscounted shall at no time exceed the capital of the bank for which the rediscounts are made. The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation, rediscounted for any one bank, shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank. (P. 38)

SEC. 27. The National Reserve Association may *through a branch* also rediscount, for and with the indorsement of any bank having a deposit with it, notes and bills of exchange arising out of commercial transactions as hereinbefore defined, having more than twenty-eight days, but not exceeding four months, to run, but in such cases the paper must be guaranteed by the local association of which the bank asking for the rediscount is a member. (P. 39)

SEC. 28. Whenever, in the opinion of the governor of the National Reserve Association, the public interests so require, such opinion to be concurred in by the executive committee of the National Reserve Association and to have the definite approval of the Secretary of the Treasury, the National Reserve Association may *through a branch* discount the direct obligation of a depositing bank, indorsed by its local association, provided that the indorsement of the local association shall be fully secured by the pledge and deposit with it of satisfactory securities, which shall be held by the local association for account of the National Reserve Association but in no such case shall the amount loaned by the National Reserve Association exceed three-fourths of the actual value of the securities so pledged. (P. 40)

Discount of
Direct Obl-
igations of
Banks

SEC. 29. *The power of rediscount and discount granted to the National Reserve Association by sections twenty-six, twenty-seven, and twenty-eight of this act shall in each case be exercised through the branch in the district in which the bank making the application is located.* (No corresponding provisions.)

Functions of
the Branches

SEC. 30. The National Reserve Association shall have authority to fix its rates of

Rates of
Discount

discount from time to time, which when so fixed shall be published, and shall be uniform throughout the United States. (P. 41)

**Bank
Acceptances**

SEC. 31. National banks are hereby authorized to accept drafts or bills of exchange drawn upon them, having not more than four months to run, properly secured, and arising out of commercial transactions as hereinbefore defined. The amount of such acceptances outstanding shall not exceed one-half the capital and surplus of the accepting bank, and shall be subject to the restrictions of section fifty-two hundred of the Revised Statutes. (P. 48)

**Purchase of
Prime Bills**

SEC. 32. The National Reserve Association may, whenever its own condition and the general financial conditions warrant such investment, purchase from a subscribing bank acceptances of banks or acceptors of unquestioned financial responsibility arising out of commercial transactions as hereinbefore defined. Such acceptances must have not exceeding ninety days to run, and must be of a character generally known in the market as prime bills. Such acceptances shall bear the indorsement of the subscribing bank selling the same, which indorsement must be other than that of the acceptor. (P. 42)

**Purchase of
Bonds and
Obligations**

SEC. 33. The National Reserve Association may invest in United States bonds; also in obligations, having not more than one year to run, of the United States or its dependencies, or of any State, or of foreign governments. (P. 43)

**Gold
Transactions**

SEC. 34. The National Reserve Association shall have power, both at home and abroad, to deal in gold coin or bullion, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of any of its holdings of United States bonds. (P. 44)

**Foreign
Checks or
Bills of
Exchange**

SEC. 35. The National Reserve Association shall have power to purchase from its subscribing banks and to sell, with or without its indorsement, checks or bills of exchange, arising out of commercial transactions as hereinbefore defined, payable in such foreign countries as the board of directors of the National Reserve Association may determine. These bills of exchange must have not exceeding ninety days to run, and must bear the signatures of two or more responsible parties, of which the last one shall be that of a subscribing bank. (P. 45)

**Agencies in
Foreign
Countries**

SEC. 36. The National Reserve Association shall have power to open and maintain banking accounts in foreign countries and to establish agencies in foreign countries for the purpose of purchasing, selling, and collecting foreign bills of exchange, and it shall have authority to buy and sell, with or without its indorsement, through such correspondents or agencies, checks or prime foreign bills of exchange arising out of commercial transactions, which have not exceeding ninety days to run, and which bear the signature of two or more responsible parties. (P. 46)

**Domestic
Exchange**

SEC. 37. It shall be the duty of the National Reserve Association or any of its branches, upon request, to transfer any part of the deposit balance of any bank having an account with it to the credit of any other bank having an account with the National Reserve Association. If a deposit balance is transferred from the books of one branch to the books of another branch, it may be done, under regulations to be prescribed by the National Reserve Association, by mail, telegraph, or otherwise, at rates to be fixed at the time by the manager of the branch at which the transaction originates. (P. 47)

Real Estate

SEC. 38. The National Reserve Association may purchase, acquire, hold, and convey real estate for the following purposes and for no other:

First. Such as shall be necessary for the immediate accommodation in the transaction of the business either of the head office or of the branches.

Second. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

Third. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.

Fourth. Such as it shall purchase at sales under judgments, decrees, or mortgages held by said association, or shall purchase to secure debts due to it.

But the National Reserve Association shall not hold the possession of any real estate under mortgage or the title and possession of any real estate purchased to secure any debts due to it for a longer period than five years. (No corresponding provisions.)

RESERVES AND REPORTS

SEC. 39. All subscribing banks must conform to the following requirements as to reserves to be held against deposits of various classes, but the deposit balance of any subscribing bank in the National Reserve Association and any notes of the National Reserve Association which it holds may be counted as the whole or any part of its required reserve: Reserves of Subscribing Banks

First. On demand deposits: National banks in different localities shall maintain the same percentages of reserve against demand deposits as is now required by law, and the same percentages of reserve against demand deposits shall be required of all other subscribing banks in the same localities.

Second. On time deposits: All time deposits and moneys held in trust payable or maturing within thirty days shall be subject to the same reserve requirements as demand deposits in the same locality. All time deposits and moneys held in trust payable or maturing more than thirty days from date shall be subject to the same reserve requirements as demand deposits for the thirty days preceding their maturity, but no reserves shall be required therefor except for this period. Such time deposits and moneys held in trust, payable only at a stated time not less than thirty days from date of deposit, must be represented by certificates or instruments in writing and must not be allowed to be withdrawn before the time specified without thirty days' notice. (P. 51, 52, 53, and 54)

SEC. 40. *National banks may loan not more than thirty per centum of their time deposits, as herein defined, upon improved and unencumbered real estate, such loans not to exceed fifty per centum of the actual value of the property, which property shall be situated in the vicinity or in the territory directly tributary to the bank: Provided, That this privilege shall not be extended to banks acting as reserve agents for banks or trust companies.* Loans upon Real Estate (P. 50)

SEC. 41. All demand liabilities, including deposits and circulating notes, of the National Reserve Association shall be covered to the extent of fifty per centum by a reserve of gold (including foreign gold coin and gold bullion) or other money of the United States which the national banks are now authorized to hold as a part of their legal reserve: Provided, That whenever and so long as such reserve shall fall and remain below fifty per centum the National Reserve Association shall pay a special tax upon the deficiency of reserve at a rate increasing in proportion to such deficiency as follows: For each two and one-half per centum or fraction thereof that the reserve falls below fifty per centum a tax shall be levied at the rate of one and one-half per centum per annum: Provided further, That no additional circulating notes shall be issued whenever and so long as the amount of such reserve falls below thirty-three and one-third per centum of its outstanding notes. Reserves of the N. R. A. (P. 55 and 68)

SEC. 42. In computing the demand liabilities of the National Reserve Association a sum equal to one-half of the amount of the United States bonds held by the association which have been purchased from national banks, and which had previously been deposited by such banks to secure their circulating notes, shall be deducted from the amount of such liabilities. (P. 56)

SEC. 43. The National Reserve Association shall make a report, showing the principal items of its balance sheet, to the Comptroller of the Currency once a week. These reports shall be made public. In addition, full reports shall be made to the Comptroller of the Currency by said association coincident with the five reports called for each year from the national banks. (P. 57) Reports by the N. R. A.

SEC. 44. All subscribing banks shall, under regulations to be prescribed by the National Reserve Association make a report monthly, or oftener if required, to said association showing the principal items of their balance sheets. (P. 59) Reports by Subscribing Banks

SEC. 45. All reports of national-bank examiners in regard to the condition of banks shall hereafter be made in duplicate, and one copy shall be filed with the National Reserve Association for the confidential use of its executive officers and branch managers. (P. 58)

SEC. 46. *The National Reserve Association may accept copies of the reports of the national-bank examiners for subscribing national banks and also copies of the reports of State-bank examiners for subscribing State banks and trust companies, in States where the furnishing of such information is not contrary to law: Provided, however, That the standard of such examinations, both National and State, meets the requirements prescribed by the National Reserve Association. The National Reserve Association shall have the right at*

any time to examine or cause to be examined by its own representatives any subscribing bank. The National Reserve Association may make such payments to national and State examiners for such services required of them as the directors may consider just and equitable. (No corresponding provisions.)

NOTE ISSUES AND UNITED STATES BONDS

National Banks and Bonds

SEC. 47. All provisions of law requiring national banks to hold or to transfer and deliver to the Treasurer of the United States bonds of the United States other than those required to secure outstanding circulating notes and Government deposits are hereby repealed. (P. 67)

Note Circulation of National Banks

SEC. 48. There shall be no further issue of circulating notes by any national bank beyond the amount now outstanding. National banks may maintain their present note issue, but whenever a bank retires the whole or any part of its existing issue its right to reissue the notes so retired shall thereupon cease. (P. 65)

2% U. S. Bonds and Redemption of Notes of the National Banks

SEC. 49. The National Reserve Association shall, for a period of one year from the date of its organization, offer to purchase at a price not less than par and accrued interest the two per centum bonds held by subscribing national banks and deposited to secure their circulating notes. The National Reserve Association shall take over the bonds so purchased and assume responsibility for the redemption upon presentation of outstanding notes secured thereby. The National Reserve Association shall issue, on the terms herein provided, its own notes as the outstanding notes secured by such bonds so held shall be presented for redemption and may issue further notes from time to time to meet business requirements, it being the policy of the United States to retire as rapidly as possible, consistent with the public interests, bond-secured circulation and to substitute therefor notes of the National Reserve Association of a character and secured and redeemed in the manner provided for in this act. (P. 66)

Reserves for Note Issue of the N. R. A.

SEC. 50. All note issues of the National Reserve Association shall at all times be covered by legal reserves to the extent required by section forty-one of this act and by notes or bills of exchange arising out of commercial transactions as hereinbefore defined or obligations of the United States. (P. 68)

Special Tax on Note Issue

SEC. 51. Any notes of the National Reserve Association in circulation at any time in excess of nine hundred million dollars which are not covered by an equal amount of lawful money, gold bullion, or foreign gold coin held by said association, shall pay a special tax at the rate of one and one-half per centum per annum and any notes in excess of one billion two hundred million dollars not so covered shall pay a special tax at the rate of five per centum per annum: Provided, That in computing said amounts of nine hundred million dollars and one billion two hundred million dollars the aggregate amount of any national-bank notes then outstanding shall be included. (P. 69)

First Lien and Redemption

SEC. 52. The circulating notes of the National Reserve Association shall constitute a first lien upon all its assets and shall be redeemable in lawful money on presentation at the head office of said association or any of its branches. *It shall be the duty of the National Reserve Association to maintain at all times a parity of value of its circulating notes with the standard established by the first section of the act of March fourteenth, nineteen hundred, entitled "An act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes."* (P. 70)

Legal-tender

SEC. 53. The circulating notes of the National Reserve Association shall be received at par in payment of all taxes, excises, and other dues to the United States, and for all salaries and other debts and demands owing by the United States to individuals, firms, corporations, or associations, except obligations of the Government which are by their terms specifically payable in gold, and for all debts due from or by one bank or trust company to another, and for all obligations due to any bank or trust company. (P. 71)

Forwarding of Notes

SEC. 54. The National Reserve Association and its branches shall at once, upon application and without charge for transportation, forward its circulating notes to any depositing bank against its credit balance. (P. 72)

3% U. S. Bonds

SEC. 55. Upon application of the National Reserve Association the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege purchased from subscribing banks for three per centum bonds of the

United States without the circulation privilege, payable after fifty years from the date of issue. The National Reserve Association shall hold the three per centum bonds so issued during the period of its corporate existence: Provided, That after five years from the date of its organization the Secretary of the Treasury may at his option permit the National Reserve Association to sell not more than fifty million dollars of such bonds annually: And provided further, That the United States reserves the right at any time to pay any of such bonds before maturity, or to purchase any of them at par for the trustees of the postal savings, or otherwise. (P. 73 and 75)

SEC. 56. The National Reserve Association shall pay to the Government a special franchise tax of one and one-half per centum annually during the period of its charter upon an amount equal to the par value of such United States bonds transferred to it by the subscribing banks. (P. 74)

Special Franchise Tax

BANKING CORPORATIONS FOR FOREIGN COUNTRIES

SEC. 57. That banking corporations for carrying on the business of banking in foreign countries and in aid of the commerce of the United States with foreign countries and to act when required as fiscal agents of the United States in such countries may be formed by any number of persons, not less in any case than five, who shall enter into articles of association which shall specify in general terms the object for which the banking corporation is formed and may contain any other provisions not inconsistent with the provisions of this section which the banking corporation may see fit to adopt for the regulation and conduct of its business and affairs, which said regulations shall be signed, in duplicate, by the persons uniting to form the banking corporation and one copy thereof shall be forwarded to the Comptroller of the Currency and the other to the Secretary of State, to be filed and preserved in their offices.

That the persons uniting to form such banking corporation shall under their hands make an organization certificate which shall specify, first, the name assumed by such banking corporation, which name shall be subject to approval by the comptroller; second, the foreign country or countries or the dependencies or colonies of foreign countries or the dependencies of the United States where its banking operations are to be carried on; third, the place in the United States where its home office shall be located; fourth, the amount of its capital stock and the number of shares into which the same shall be divided; fifth, the names and places of residence of the shareholders and the number of shares held by each of them; and, sixth, a declaration that said certificate is made to enable such persons to avail themselves of the advantages of this section.

That no banking corporation shall be organized under the provisions of this section with a less capital than two million dollars, which shall be fully paid in before the banking corporation shall be authorized to commence business, and the fact of said payment shall be certified by the Comptroller of the Currency and a copy of his certificate to this effect shall be filed with the Secretary of State: Provided, That the capital stock of any such bank may be increased at any time by a vote of two-thirds of its shareholders with the approval of the Comptroller of the Currency and that the capital stock of any such bank which exceeds two million dollars may be reduced at any time to the sum of two million dollars by the vote of shareholders owning two-thirds of the capital.

That every banking corporation formed pursuant to the provisions of this section shall for a period of twenty years from the date of the execution of its organization certificate be a body corporate, but shall not be authorized to receive deposits in the United States nor transact any domestic business not necessarily related to the business being done in foreign countries or in the dependencies of the United States. Such banking corporations shall have authority to make acceptances, buy and sell bills of exchange, or other commercial paper relating to foreign business, and to purchase and sell securities, including securities of the United States or of any State in the Union. Each banking corporation organized under the provisions of this section shall have power to establish and maintain for the transaction of its business a branch or branches in foreign countries, their dependencies, or the dependencies of the United States at such places and under such regulations as its board of directors may deem expedient.

A majority of the shares of the capital stock of such banking corporation shall be held and owned by citizens of the United States or corporations chartered under the laws of

the United States or of any State of the Union, and a majority of the members of the board of directors of such banking corporations shall be citizens of the United States. Each director shall own in his own right at least one hundred shares of the capital stock of the banking corporation of which he is a director.

Whenever the Comptroller shall become satisfied of the insolvency of any such banking corporation he may appoint a receiver who shall proceed to close up such corporation in the same manner in which he would close a national bank, the disposition of the assets of the branches to be subject to any special provisions of the laws of the country under whose jurisdiction such assets are located.

The annual meeting of every such banking corporation shall be held at its home office in the United States, and every such banking corporation shall keep at its home office books containing the names of all stockholders of such banking corporation and members of its board of directors, together with copies of the reports furnished by it to the Comptroller of the Currency exhibiting in detail and under appropriate heads the resources and liabilities of the banking corporation. Every such banking corporation shall make reports to the Comptroller of the Currency at such times as he may require, and shall be subject to examinations when deemed necessary by the Comptroller of the Currency through examiners appointed by him; the compensation of such examiners to be fixed by the Comptroller of the Currency.

Any such banking corporation may go into liquidation and be closed by the vote of its shareholders owning two-thirds of its stock.

Any bank doing business in the United States and being the owner of stock in the National Reserve Association may subscribe to the stock of any banking corporation organized under the provisions of this section, but the aggregate of such stock held by any one bank shall not exceed ten per centum of the capital stock of the subscribing bank.
(P. 49)

PROVISION FOR AMENDMENTS

SEC. 58. Congress reserves the right to alter or amend the provisions of this act to take effect at the end of any decennial period from and after the organization of the National Reserve Association. (No corresponding provisions.)

SEC. 59. All acts or parts of acts inconsistent with the provisions of this act are hereby repealed. (No corresponding provisions.)

NELSON W. ALDRICH,
Chairman.

EDWARD B. VREELAND,
Vice Chairman.

JULIUS C. BURROWS.

EUGENE HALE.

H. M. TELLER.

H. D. MONEY.

THEODORE E. BURTON.

JAS. P. TALIAFERRO.

BOIES PENROSE.

JOHN W. WEEKS.

ROBT. W. BONYNGE.

L. P. PADGETT.

GEO. F. BURGESS.

A. P. PUJO.

GEO. W. PRINCE.

JAMES McLACHLAN.

A. PIATT ANDREW,
Assistant to Commission.

ARTHUR B. SHELTON,
Secretary.

WASHINGTON, January 8, 1912.

B. Suggested Plan

(Revised Edition)

Italics indicate changes from the original edition, "Suggested Plan for Monetary Legislation." Parentheses refer to sections of the National Monetary Commission Bill, introduced in Congress January 8th, 1912.

CHARTER CAPITAL AND LOCATION

1. It is proposed to charter the *National Reserve Association* of the United States, which shall be the principal fiscal agent of the Government of the United States. The authorized capital of the National Reserve Association shall be 20 per cent of the capital of the banks eligible for membership (approximately 300 millions). The length of its charter shall be 50 years. The head office of the association shall be in Washington, D. C. (B. 1 and 23)

MEMBERSHIP

2. All national banks and all State banks and trust companies which comply with the requirements for membership hereinafter set forth (secs. 60-64) may subscribe to the capital stock of the National Reserve Association. (*The word "bank," when used hereinafter, shall be understood to refer to all such national banks, State banks, and trust companies as shall comply with the requirements for membership hereinafter defined.*) A bank having a minimum capital of \$25,000 may subscribe to an amount of capital stock of the National Reserve Association equal to 20 per cent of the stock of the subscribing bank, and not less, and each of such subscribing banks shall become a member of a local association as hereinafter provided. Fifty per cent of the subscriptions to the capital stock of the National Reserve Association shall be called in cash; the balance of the subscriptions will remain a liability of the subscribers, subject to call. (B. 3)

3. Shares of the capital stock of the National Reserve Association shall not be transferable, and under no circumstances may they be owned by any corporation other than the subscribing bank nor by any individual, nor may they be owned by any bank in any other amount than in the proportion herein provided. In case a subscribing bank increases its capital, it shall thereupon subscribe for an additional amount of the capital stock of the National Reserve Association equal to 20 per cent of the bank's increase of capital, paying therefor its then book value, as shown by the last published statement of the Association. A bank applying for membership in the Association after its formation must subscribe for a proportional share of its capital stock, paying therefor its then book value. In case a subscribing bank reduces its capital, it shall surrender a proportionate amount of its holdings of the capital stock of the National Reserve Association. If a bank goes into liquidation, it shall surrender all of its holdings of the capital stock of the National Reserve Association. The shares surrendered shall be cancelled and the bank shall receive in payment therefor a sum equal to their book value. (B. 12)

EARNINGS AND DIVIDENDS

4. The earnings of the National Reserve Association shall be distributed in the following manner:

After the payment of all expenses and taxes the stockholders shall receive 4 per cent. Further earnings shall be divided, one-half to go to the surplus of the National Reserve Association until that surplus shall amount to 20 per cent of the paid-in capital, one-fourth to go to the Government of the United States, and one-fourth to the stockholders; but when the stockholder's dividends shall reach 5 per cent they shall receive no additional distribution. After the stockholders receive 5 per cent the earnings shall be divided, one-half to be added to the surplus of the National Reserve Association and one-half to go to the Government. After the stockholders receive 5 per cent per annum and the surplus of the National Reserve Association amounts to 20 per cent of the paid-in capital, all excess earnings shall go to the Government. The minimum dividends to the stockholders shall be cumulative. (B. 19)

ORGANIZATION

5. All subscribing banks shall be formed into associations of banks, to be designated as local associations. Every local association *shall have corporate powers* and shall be composed of not less than 10 banks, and the combined capital and surplus of the members of each local association shall aggregate not less than \$5,000,000. The territory included in the local associations shall be so apportioned that every bank will be located within the boundaries of some local association. Every subscribing bank shall become a member of the local association of the territory in which it is situated. (B. 6)

6. All of the local associations shall be grouped into divisions, to be called districts.

The country shall be divided at first into 15 districts, and a branch of the National Reserve Association shall be located in each district, the location to be determined by the directors of the National Reserve Association. *The districts may be readjusted from time to time, and new districts and new branches may be created by the directors.* (B. 5)

7. *The National Reserve Association and its branches and the local associations shall be exempt from State and local taxation, except in respect to taxes upon real estate.* (B. 13)

OFFICERS AND DIRECTORS

(A) DIRECTORS OF LOCAL ASSOCIATIONS

8. Each local association shall elect annually a board of directors, the number to be determined by the by-laws of the local associations. Three-fifths of that number shall be elected by ballot cast by the representatives of the banks that are members of the local association, each bank having one representative and each representative one vote, without reference to the size of the bank. Two-fifths of the whole number of directors of the local association shall be elected by these same representatives of the several banks that are members of the association, but in voting for these additional directors each representative shall be entitled to as many votes as the bank which he represents holds shares in the National Reserve Association. At such elections there shall be no proxies. The authorized representatives of a bank, as herein provided, must be either the president, vice president, or cashier of the bank he represents. (B. 7)

(B) DIRECTORS OF BRANCHES

9. Each of the branches of the National Reserve Association shall have a board of directors, to be elected in the following manner:

The board of directors of each local association shall elect by ballot one member of the board of directors of the branch of the National Reserve Association. In this manner there will thus be elected as many directors of the branch of the National Reserve Association as there may be local associations in the district in which that branch of the National Reserve Association is located. (B. 8)

10. In addition to that number there shall be elected in the following manner a

number of directors equal to two-thirds of the number of local associations in the district where the branch is located. There shall be chosen by the banks composing each local association a voting representative or proxy holder. In choosing such voting representative each bank shall be entitled to as many votes as it holds shares in the National Reserve Association. The voting representatives of the several local associations which form a district shall elect an additional number of directors of the branch equal to two-thirds of the number elected directly by the local association; that is, equal to two-thirds of the number of local associations composing the district. Each voting representative at such election shall have a number of votes equal to the number of shares in the National Reserve Association held by all the banks composing the local association which he represents. (B. 8)

11. The board of the branch as thus constituted shall at once add to its numbers by the election of an additional number of directors equal to one-third the number of local associations situated in the district. Such additional directors shall fairly represent the industrial, commercial, agricultural, and other interests of the district, and shall not be officers of banks. Directors of banks shall not be considered as officers. (B. 8)

12. The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board.

The board of directors of a branch of the National Reserve Association will thus be composed of—

First. A group of directors equal in number to the number of local associations composing the district, and this group shall be elected by the local associations, each association having one vote.

Second. A group of directors equal to two-thirds of the foregoing group and elected by stock representation.

Third. A group of directors equal in number to one-third of the first group, representing the industrial, commercial, agricultural, and other interests of the district, and elected by the votes of the first two groups, each director thus voting having one vote.

Fourth. The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board. (B. 8)

13. All the members of the board of directors of the branch, except the ex officio member, shall at the first meeting of the board be classified in three classes, and the terms of office of these three classes shall be, respectively, one, two, and three years. Thereafter members of the board shall be elected for a term of three years. (B. 8)

(C) DIRECTORS OF THE NATIONAL RESERVE ASSOCIATION

14. The board of the National Reserve Association shall at first consist of 45 directors, and shall be constituted in the following manner:

First. Six ex officio members, namely, the governor of the National Reserve Association, who shall be the chairman of the board; two deputy governors of the National Reserve Association, the Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the Currency. (B. 9)

15. Second. Fifteen directors to be elected, one by the board of directors of each branch of the National Reserve Association. In case the number of districts shall be increased hereafter, each additional district shall be entitled to elect an additional director. (B. 9)

16. Third. Twelve directors, who shall be elected by voting representatives of the various districts, each of whom shall cast a number of votes equal to the number of shares in the National Reserve Association held by all the banks in the district which he represents. (B. 9)

17. Fourth. The twenty-seven directors thus elected shall in turn elect twelve additional members, who shall fairly represent the industrial, commercial, agricultural, and other interests of the country, and who shall not be officers of banks. Directors of banks shall not be considered as officers. (B. 9)

18. *Not more than three of the directors elected under paragraphs 16 and 17 shall be chosen from one district.* (B. 9)

19. At the first meeting of the board all the members of the board, except the ex

officio members, shall be classified into three classes, and the terms of office of these three classes shall be, respectively, one, two, and three years. Thereafter members of the board shall be elected for a term of three years. (B. 9)

20. No member of any national or State legislative body shall be a director of the National Reserve Association, nor of any of the branches, nor of any local association. (B. 9)

(D) COMMITTEES OF THE NATIONAL RESERVE ASSOCIATION

21. The directors of the National Reserve Association shall annually elect *from their number* an executive committee and such other committees as the by-laws of the National Reserve Association may provide. The executive committee shall consist of nine members, of which the governor of the National Reserve Association shall be ex officio chairman and the two deputies and the Comptroller of the Currency ex officio members, *but not more than one of the elected members shall be chosen from one district.* (B. 14)

22. The executive committee shall have all the authority which is vested in the board of directors, except such as may be specifically delegated by the board to other committees or to the executive officers, *or such as may be specifically reserved or retained by the board.* (B. 14)

23. There shall be a board of supervision elected by the board of directors from among its number, of which the Secretary of the Treasury shall be ex officio chairman. (B. 15)

(E) EXECUTIVE OFFICERS OF THE NATIONAL RESERVE ASSOCIATION

24. The executive officers of the National Reserve Association shall consist of a governor, two deputy governors, a secretary, and such subordinate officers as may be provided by the by-laws. The governor shall be selected by the President of the United States from a list submitted by the board of directors, and shall be subject to removal *by a two-thirds vote of the board of directors* for cause. The term of office of the deputies shall be seven years, but the two deputies first elected shall serve for terms of four years and seven years, respectively. The deputies shall be *elected by the board of directors and may be removed for cause at any time and their places filled by the board.* In the absence of the governor or his inability to act, the deputy who is senior in point of service shall act as governor. (B. 10)

(F) EXECUTIVE OFFICERS OF BRANCHES

25. Each branch shall have a manager and a deputy manager appointed by the governor of the National Reserve Association, with the approval of the executive committee. (B. 16)

26. The powers and duties of the manager and deputy manager and of the various committees of the branches shall be prescribed by the by-laws of the National Reserve Association. (B. 16)

(G) EXECUTIVE OFFICERS OF THE LOCAL ASSOCIATIONS

27. The directors of the local association shall annually elect *from among their number* a president, a vice president, and an executive committee, whose powers and duties and terms of office shall be determined by the by-laws of the local association, *subject, however, to the provisions of this Act.* (B. 17)

28. The local associations, the branches, and the National Reserve Association shall each have by-laws which shall provide, among other things, a method of filling vacancies on their respective boards of directors.

The by-laws of the local associations and of the branches shall be subject to the approval of the National Reserve Association. (B. 7, 8, and 9)

[The Act will provide a preliminary organization for the Reserve Association, to remain in effect until the permanent organization created by the foregoing sections can be perfected.] (B. 4)

FUNCTIONS OF THE LOCAL ASSOCIATIONS

29. Any member of a local association may apply to such association for a guaranty of the commercial paper which it desires to rediscount at the branch of the National Reserve Association in its district. Any such bank receiving a guaranty from a local association shall pay a commission to the local association, to be fixed in each case by its board of directors. The guaranty of the local association, in the event of loss, shall be met by the members of the local association in proportion to the ratio which their capital and surplus bears to the aggregate capital and surplus of the members of the local association, and the commission received for such guaranty, after the payment of expenses and possible losses, shall be distributed among the several banks of the local association in the same proportion. A local association shall have authority to require security from any bank offering paper for guaranty, or it may decline to grant the application. (B. 20)

30. The total amount of guaranties by a local association to the National Reserve Association shall not at any time exceed the aggregate capital and surplus of the banks forming the guaranteeing association. (B. 20)

31. *Any local association may by a vote of three-fourths of its members and with the approval of the National Reserve Association, assume and exercise such of the powers and functions of a clearing house as are not inconsistent with the purposes of this Act. The National Reserve Association may require any local association to perform such services in facilitating the domestic exchanges of the Reserve Association as the public interests may require.* (B. 21)

32. *The local associations shall appoint examiners, who shall have authority to examine into the condition of the banks composing the association under such regulations as may be adopted by the local association, with the approval of the National Reserve Association. Copies of the reports of these examinations shall upon request be furnished to the executive officers of the National Reserve Association and of its branches. (In the Bill no corresponding provisions.)*

33. *A local association may by a vote of two-thirds of its members suspend a bank from the privileges of membership for a failure for thirty days to maintain its reserves, or to make the reports required by this Act, or for misrepresentation in any report or examination as to its condition or as to the character or extent of its assets or liabilities.* (B. 22)

FUNCTIONS OF THE NATIONAL RESERVE ASSOCIATION

34. All of the privileges and advantages of the National Reserve Association shall be equitably extended to every bank of any of the classes herein defined which shall subscribe to its proportion of the stock of the National Reserve Association and shall otherwise conform to the requirements of this Act. (B. 22)

35. The Government of the United States and those banks owning stock in the National Reserve Association shall be the sole depositors in the National Reserve Association. All domestic transactions of the National Reserve Association shall be confined to the Government and the subscribing banks, with the exception of the purchase or sale of Government or State securities or securities of foreign Governments or of gold coin or bullion. (B. 24)

36. The Government of the United States shall deposit its cash balance with the National Reserve Association, and thereafter all receipts of the Government shall be deposited with the National Reserve Association, [except that when necessary the Government may designate national banks for that purpose in cities where there is no branch of the National Reserve Association].* All disbursements by the Government shall be made through the National Reserve Association. (B. 23)

37. The National Reserve Association shall pay no interest on deposits. (B. 25)

38. The National Reserve Association may rediscount for and with the indorsement of any bank having a deposit with it, notes and bills of exchange arising out of commercial transactions. (*This language, whenever used, is intended to apply to all notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, and not for carrying stocks, bonds, or other investment securities.*)

* Provision for designation of national banks omitted from final bill.

Such notes and bills must have a maturity of not more than 28 days, and must have been made at least 30 days prior to the date of rediscount. The amount so rediscounted shall in no case exceed the capital of the bank applying for the rediscount. The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, corporation, or firm, rediscounted for any one bank, shall at no time exceed 10 per cent of the capital and surplus of said bank. (B. 26)

39. The National Reserve Association may also rediscount, for *and with the indorsement of any bank* having a deposit with it, notes and bills of exchange arising out of commercial transactions as hereinbefore defined, having more than 28 days, but not exceeding 4 months, to run, but in such cases the paper must be guaranteed by the local association of which the bank asking for the rediscount is a member. (B. 27)

40. Whenever, in the opinion of the governor of the National Reserve Association, the public interests so require, such opinion to be concurred in by the executive committee of the National Reserve Association and to have the definite approval of the Secretary of the Treasury, the National Reserve Association may discount the direct obligation of a depositing bank, indorsed by its local association, provided that the indorsement of the local association shall be fully secured by the pledge and deposit with it of satisfactory securities, which shall be held by the local association for account of the National Reserve Association; but in no such case shall the amount loaned by the National Reserve Association exceed *three-fourths* of the actual value of the securities so pledged. (B. 28)

41. The rates of discount which the National Reserve Association shall have authority to fix from time to time shall be published when fixed, and shall be uniform throughout the United States. (B. 30)

42. The National Reserve Association may, whenever its own condition and the general financial conditions warrant such investment, purchase [to a limited amount]* from a subscribing bank acceptances of banks or houses of unquestioned financial responsibility. Such acceptances must have arisen out of commercial transactions, must have not exceeding 90 days to run, and must be of a character generally known in the market as prime bills. Such acceptances shall bear the indorsement of the subscribing bank selling the same, which indorsement must be other than that of the acceptor. (B. 32)

43. The National Reserve Association may invest in United States bonds and in short-term obligations—that is, obligations having not more than one year to run—of the United States or its dependencies, or of any State, or of foreign governments. (B. 33)

44. The National Reserve Association shall have power at home and abroad to deal in gold coin or bullion, to grant loans thereon, and to contract for loans of gold coin or bullion, and to give therefor, when necessary, acceptable security, *including the hypothecation of any of its holdings of United States bonds*. (B. 34)

45. The National Reserve Association shall have power to purchase from its subscribers and to sell, with or without its indorsement, checks or bills of exchange payable in England, France, or Germany, and in such other foreign countries as the board of the National Reserve Association may decide. These bills of exchange must have arisen out of commercial transactions, must have not exceeding 90 days to run, and must bear the signatures of two or more responsible parties, of which the last one shall be that of a subscribing bank. (B. 35)

46. The National Reserve Association shall have power to open and maintain banking accounts in foreign countries and to establish agencies in foreign countries for the purpose of purchasing and selling and collecting foreign bills of exchange, and it shall have authority to buy and sell, with or without its indorsement, through such correspondents or agencies, checks or prime foreign bills of exchange which have arisen out of commercial transactions, which have not exceeding 90 days to run, and which bear the signatures of two or more responsible parties. (B. 36)

DOMESTIC EXCHANGES

47. It shall be the duty of the National Reserve Association or any of its branches, upon request, to transfer any part of the deposit balance of any bank having an account with it to the credit of any other bank having an account with the National Reserve

* Omitted from final bill.

Association. If a deposit balance is transferred from the books of one branch to the books of another branch, it may be done, *under regulations to be prescribed by the National Reserve Association, by mail or telegraph at rates to be fixed at the time by the executive committee of the branch at which the transaction originates.* (See also sec. 72.) (B. 37)

FUNCTIONS OF NATIONAL BANKS

48. In addition to the rights now conferred by law, national banks shall be authorized to accept commercial paper drawn upon them, having not more than four months to run, properly secured, and arising out of commercial transactions. The amount of such acceptances outstanding shall not exceed one-half the capital and surplus of the accepting bank, and shall be subject to the restrictions of section 5200 of the Revised Statutes. (B. 31)

49. The organization of banks to conduct business in foreign countries and in the dependencies of the United States shall be authorized. The stock of such banks may be held by national banks, but the aggregate of such stock held by any one bank shall not exceed 20 per cent of the capital of that bank.

The bank so organized may have an office in the United States, but shall not receive deposits in the United States nor compete with national banks for domestic business not necessarily related to the business being done in foreign countries or in the dependencies of the United States. (B. 57)

50. National banks shall be given the right, under proper restrictions and regulations to be defined in the Act, to establish separate savings departments, and to lend, under proper restrictions, not more than 40 per cent of their savings deposits upon productive real estate, such loans not to exceed 50 per cent of the actual value of the property. (B. 40)

RESERVES

(A) RESERVES OF SUBSCRIBING BANKS

51. All subscribing banks must conform to the following requirements as to reserves to be held against deposits of various classes, but the deposit balance of any subscribing bank in the National Reserve Association and any notes of the National Reserve Association which it holds may be counted as a part of its required reserve. (B. 39)

52. (1) *Demand deposits.*—There shall be no change in the percentages of reserve required by law to be held against demand deposits by national banks in different localities, and hereafter the same percentages of reserve against demand deposits shall be required of all subscribing banks in the same localities. (B. 39)

53. (2) *Time Deposits.*—All time deposits and moneys held in trust payable or maturing within 30 days shall be subject to the same reserve requirements as are demand deposits in the same locality.

All time deposits and moneys held in trust payable or maturing more than 30 days from date shall be subject to the same reserve requirements as demand deposits for the 30 days preceding their maturity, but no reserves shall be required therefor except for this period. Such time deposits and moneys held in trust must be represented by certificates or instruments in writing and be payable only at a stated time not less than 30 days from date of deposit, and must not be allowed to be withdrawn before the time specified without 30 days' notice. (B. 39)

54. (3) *Savings Deposits.*—Savings deposits to be defined in the Act, shall be subject to notice of 30 days or more and shall be covered by a reserve amounting to 40 per cent of that required of demand deposits in the same locality. (B. 39)

(B) RESERVES OF NATIONAL RESERVE ASSOCIATION

55. All demand liabilities, including deposits and circulating notes, of the National Reserve Association shall be covered to the extent of 50 per cent by a reserve of gold (including foreign gold coin and gold bullion) or of other money of the United States which the national banks are now authorized to hold as a part of their legal reserve; provided, however, that whenever and so long as such reserve shall fall and remain below 50

per cent the National Reserve Association shall pay a special tax upon the deficiency of reserve at a rate increasing in proportion to such deficiency as follows: For each $2\frac{1}{2}$ per cent or fraction thereof that the reserve falls below 50 per cent the percentage of taxation shall increase at the rate of $1\frac{1}{2}$ per cent per annum. (B. 41)

56. In computing the demand liabilities of the Association a sum equal to one-half of the amount of the United States bonds held by the Association which have been purchased from the national banks, and which had previously been deposited by those banks to secure their circulating notes, shall be deducted. (B. 42)

REPORTS

57. The National Reserve Association shall make a report, showing the principal items of its balance sheet, to the Comptroller of the Currency once a week. These reports shall be made public. In addition, full reports shall be made to the Comptroller of the Currency coincident with the five reports called for each year from the national banks. (B. 43)

58. All reports of national-bank examiners in regard to the condition of banks shall hereafter be made in duplicate, and one copy shall be filed with the National Reserve Association for the confidential use of its executive officers and branch managers. (B. 45)

59. All subscribing banks shall, under regulations to be prescribed, make a report monthly, or oftener if required, to the National Reserve Association showing the principal items of their balance sheets. (B. 44)

STATE BANKS AND TRUST COMPANIES

60. A bank or a trust company which is incorporated under the laws of any State may subscribe to the capital stock of the National Reserve Association in the same manner and under the same conditions as prescribed for national banks, and such subscribing bank shall become a member of a local association and have the same rights and privileges therein as if it were a national bank; provided—(B. 3)

61. (1) That (a) if a bank, it shall have a paid-in capital of not less than that required for a national bank in the same location; and that (b) if a trust company, it shall have an unimpaired surplus of not less than 20 per cent of its capital, and if located in a city of 25,000 inhabitants or less, shall have a paid-in capital of not less than \$100,000, and in a larger city a proportionately greater capital up to \$500,000 in a city of 500,000 inhabitants or more. (B. 3)

62. (2) That it shall have and agree to maintain against its demand deposits a reserve of like character and proportion to that required by law of a national bank in the same location; provided, however, that deposits which it may have with any subscribing national bank, State bank, or trust company in a city designated in the national banking laws as a reserve city or a central reserve city shall count as reserve in like manner and to the same extent as similar deposits of a national bank with national banks in such cities. (B. 3)

63. (3) That it shall have and agree to maintain against all other classes of deposits the percentages of reserve required by this Act. (B. 3)

64. (4) That it shall agree to submit to such examinations and to make such reports as are required by law and to comply with the requirements and conditions imposed by this Act. (B. 3)

NOTE ISSUES

65. There shall be no further issue of circulating notes beyond the amount now outstanding by any national bank. National banks may, if they choose, maintain their present note issue, but whenever a bank retires the whole or any part of its existing issue it shall permanently surrender its right to reissue the notes so retired. (B. 48)

66. The National Reserve Association must, for a period of one year, offer to purchase at a price not less than par and accrued interest the 2 per cent bonds held by subscribing national banks and deposited to secure their circulating notes. The National Reserve Association shall take over these bonds and assume responsibility for the redemption (upon

presentation) of outstanding notes secured thereby. The National Reserve Association shall issue, on the terms herein provided, its own notes as fast as the outstanding notes secured by such bonds so held shall be presented for redemption, and may issue other notes from time to time to meet business requirements, it being the policy of the United States to retire as rapidly as possible, consistent with the public interests, bond-secured circulation and to substitute therefor notes of the National Reserve Association of a character and secured and redeemed in the manner provided for in this Act. (B. 49)

67. *All provisions of law requiring national banks to hold or to transfer and deliver to the Treasurer of the United States United States bonds other than those required to secure outstanding circulating notes and Government deposits shall be repealed.* (B. 47)

68. All note issues of the National Reserve Association must be covered to the extent of at least one-third by gold or other lawful money, and the remaining portion by bankable commercial paper as herein defined or obligations of the United States, *but no notes shall be issued whenever the lawful money so held shall fall below one-third of the notes outstanding.* (B. 41 and 50)

69. *Any notes of the Reserve Association in circulation at any time in excess of \$900,000,000¹ which are not covered by an equal amount of lawful money held by the association shall pay a special tax at the rate of 1½ per cent annum, and any notes in excess of \$1,200,000,000 not so covered shall pay a special tax at the rate of 5 per cent per annum.* (B. 51)

70. The notes are to constitute a first lien upon all the assets of the National Reserve Association, and shall be redeemable in lawful money on presentation at the head office of the National Reserve Association or any of its branches. (B. 52)

71. The notes of the National Reserve Association shall be received at par in payment of all taxes, excises, and other dues to the United States, and for all salaries and other debts and demands owing by the United States to individuals, corporations, or associations, except obligations of the Government which are by their terms specifically payable in gold, and for all debts due from or by one bank to another, and for all obligations due to a bank. (B. 53)

72. *The National Reserve Association and its branches shall at once, upon application and without charge for transportation, forward its circulating notes to any depositing bank against its credit balance.* (B. 54)

UNITED STATES BONDS

73. Upon the application of the National Reserve Association the Secretary of the Treasury shall exchange the 2 per cent bonds bearing the circulation privilege purchased from the banks for 3 per cent bonds without the circulation privilege, payable after fifty years from the date of issue. (B. 55)

74. The National Reserve Association shall pay to the Government a special franchise tax of 1½ per cent annually during the period of its charter upon an amount equal to the par value of such bonds transferred to it by the subscribing banks. (B. 56)

75. The Reserve Association shall agree to hold the 3 per cent bonds so issued *during the period of its corporate existence*, provided that after five years the Secretary of the Treasury may at his option permit the Reserve Association to sell not more than fifty millions of such bonds annually; and provided further that the United States reserves the right at any time to pay any of such bonds before maturity, or to purchase any of them at par for the trustees of the postal savings, or otherwise. (B. 55)

[The effect of this exchange and agreement will be to enable the United States to provide permanently for a large part of the public debt at a net interest charge of 1½ per cent.]

¹ The \$900,000,000 and \$1,200,000,000 are to be understood as including any national-bank notes which may be outstanding at the time. [Foot note in the "Plan"].

C. Suggested Plan

(Original Edition)

CHARTER AND LOCATION

It is proposed to charter the Reserve Association of America, which will be the principal fiscal agent of the Government of the United States. The authorized capital of the Reserve Association shall be approximately \$300,000,000. The length of its charter shall be 50 years. The head office of the association shall be in Washington, D. C.

The country shall be divided into 15 districts, and a branch of the Reserve Association shall be located in each district.

The Reserve Association and its branches shall be exempt from State and local taxation, except in respect to taxes upon real estate owned by it.

CAPITAL

Only national banks of the classes hereinafter provided for may subscribe to the capital stock of the Reserve Association. A national bank having a minimum capital of at least \$25,000 may subscribe to an amount of capital stock of the Reserve Association equal to 20 per cent of the stock of the subscribing national bank, and not less, and each of such subscribing banks shall become a member of a local association as hereinafter provided for. Fifty per cent of the subscriptions to the capital stock of the Reserve Association shall be called in cash; the balance of the subscriptions will remain a liability of the stockholders, subject to call.

Shares of the capital stock of the Reserve Association will not be transferable, and under no circumstances may they be owned by any corporation other than the subscribing national bank, nor by any individual, nor may they be owned by any national bank in any other amount than in the proportion here provided. In the case of a national bank increasing its capital after it once becomes a subscriber to the stock of the Reserve Association, the national bank shall thereupon subscribe for an additional amount of the capital stock of the Reserve Association equal to 20 per cent of the national bank's increase of capital, paying therefor its then book value, but only one-half of this additional subscription will be called in cash, as hereinbefore provided. In the event of a national bank which is a holder of the capital stock of the Reserve Association decreasing its capital, it shall surrender a proportionate amount of its holdings of the capital stock of the Reserve Association; or if a national bank goes into liquidation, it shall surrender all of its holdings of the capital stock of the Reserve Association. The capital of the Reserve Association so surrendered shall be cancelled, and the national bank thus surrendering stock in the Reserve Association shall receive in payment therefor a sum equal to the then book value, as shown on the balance sheet of the Reserve Association, of the stock so surrendered.

EARNINGS AND DIVIDENDS

The earnings of the Reserve Association shall be distributed in the following manner:

After the payment of all expenses and taxes the stockholders shall receive 4 per cent. Further earnings shall be divided, one-half to go to the surplus of the Reserve Association until that surplus shall amount to 20 per cent of the paid-in capital; one-fourth to go to the Government of the United States, and one-fourth to the stockholders; but when the stockholders' dividends shall reach 5 per cent they shall receive no additional distribution. After the stockholders receive 5 per cent the earnings shall be divided, one-half to be added to the surplus of the Reserve Association and one-half to go to the Government. After the stockholders receive 5 per cent per annum and the surplus of the Reserve Association amounts to 20 per cent of the paid-in capital, all excess earnings shall go to the Government. The minimum dividends to the stockholders shall be cumulative.

LOCAL ASSOCIATIONS OF NATIONAL BANKS

All subscribing banks shall be formed into associations of national banks, to be designated as local associations. Every local association shall be composed of not less than 10 banks, and the combined capital and surplus of the members of each local association shall aggregate not less than \$5,000,000.

All the local associations shall be grouped into 15 divisions, to be called districts. The territory included in the local associations shall be so apportioned that every national bank will be located within the boundaries of some local association. Every subscribing national bank shall become a member of the local association of the territory in which it is situated.

DIRECTORS OF LOCAL ASSOCIATIONS

Each local association shall elect annually a board of directors in the following manner:

The number of the directors may be determined by the by-laws of the local associations. Three-fifths of that number shall be elected by ballot cast by the representatives of the banks that are members of the local association, each bank having one representative, and each representative one vote, without reference to the size of the bank. Two-fifths of the whole number of directors of the local association shall be elected by these same representatives of the several banks that are members of the association, but in voting for these additional directors each representative shall be entitled to as many votes as the bank which he represents holds shares in the Reserve Association. At such elections there shall be no proxies. The authorized representatives of a bank, as herein provided, must be either the president, vice president, or cashier of the bank he represents.

DIRECTORS OF BRANCHES

As heretofore provided, all the local associations shall be grouped into 15 divisions, and each of these divisions shall be designated a district. There shall be located in each district a branch of the Reserve Association. Each of the 15 branches of the Reserve Association shall have a board of directors, and those directors shall be elected in the following manner:

The board of directors of each local association shall elect by ballot one member of the board of directors of the branch of the Reserve Association. In this manner there will thus be elected as many directors of the branch of the Reserve Association as there may be local associations in the district in which that branch of the Reserve Association is located. In addition to that number there shall be elected a number of the directors equal to two-thirds of the number of local associations in the district where the branch is located. Such additional directors shall be elected in the following manner:

There shall be chosen by the banks composing each local association a voting representative or proxy holder. In choosing such voting representative each bank shall be entitled to as many votes as it holds shares in the Reserve Association. The voting representatives of the several local associations which form a district shall then meet at the office of the branch and elect an additional number of directors of the branch equal to two-thirds of

the number elected directly by the local associations; that is, equal to two-thirds of the number of local associations composing the district. Each voting representative at such election shall have a number of votes equal to the number of shares in the Reserve Association held by all the banks composing the local association which he represents.

The first business of the board of the branch as thus constituted shall be to add to its numbers by the election of an additional number of directors equal to one-third the number of local associations situated in the district. Such additional directors shall fairly represent the industrial, commercial, agricultural, and other interests of the district and shall not be officers of banks. Directors of banks shall not be considered as officers.

The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board.

The board of directors of a branch of the Reserve Association will thus be composed of—

First. A group of directors equal in number to the number of local associations composing the district, and this group shall be elected by the directors of the local association, each director having one vote.

Second. A group of directors equal to two-thirds of the foregoing group and elected by stock representation.

Third. A group of directors equal in number to one-third of the first group, representing the industrial, commercial, agricultural, and other interests of the district, and elected by the votes of the first two groups, each director thus voting having one vote.

Fourth. The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board.

All the members of the board of directors of the branch, except the ex officio member, shall, at the first meeting of the board, be classified into three classes, and the terms of office of these three classes shall be, respectively, one, two, and three years. Thereafter members of the board shall be elected for a term of three years.

DIRECTORS OF THE RESERVE ASSOCIATION

The board of the Reserve Association shall consist of 45 directors, and it shall be composed in the following manner:

First. Six ex officio members, namely, the governor of the Reserve Association, who shall be chairman of the board; two deputy governors of the Reserve Association, the Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the Currency.

Second. Fifteen directors to be elected, one by the board of directors of each branch of the Reserve Association. They shall be elected by ballot, each member of the branch board having one vote.

Third. Twelve directors, who shall be elected by voting representatives, one representing the banks embraced in each district. Each voting representative shall cast a number of votes equal to the number of shares in the Reserve Association held by all the banks in the district which he represents.

Fourth. The board as thus constituted shall select 12 additional members, who shall fairly represent the industrial, commercial, agricultural, and other interests of the country, and who shall not be officers of banks. Directors of banks shall not be considered as officers.

At the first meeting of the board all the members of the board, except the ex officio members, shall be classified into three classes, and the terms of office of these three classes shall be, respectively, one, two, and three years. Thereafter members of the board shall be elected for a term of three years.

No member of any national or State legislative body shall be a director of the Reserve Association, nor of any of the branches, nor of any local association.

The directors of the Reserve Association shall annually elect an executive committee and such other committees as the by-laws of the Reserve Association may provide. The executive committee shall consist of nine members, of which the governor of the Reserve Association shall be ex officio chairman and the two deputies and the Comptroller of the Currency ex officio members.

The executive committee shall have all the authority which is vested in the board of

directors, except such as may be specifically delegated by the board to other committees or to the executive officers.

There shall be a board of supervision elected by the board of directors from among its number, of which the Secretary of the Treasury shall be ex officio chairman.

EXECUTIVE OFFICERS OF THE RESERVE ASSOCIATION

The executive officers of the Reserve Association shall consist of a governor, two deputy governors, a secretary, and such subordinate officers as may be provided by the by-laws. The governor and deputy governors shall be selected by the President of the United States from a list submitted by the board of directors. The governor shall be subject to removal by the President of the United States for cause. The term of office of the deputies shall be seven years, but the two deputies first appointed shall be for terms of four years and seven years respectively.

In the absence of the governor or his inability to act, the deputy who is senior in point of service shall act as governor.

EXECUTIVE OFFICERS OF BRANCHES

Each branch shall have a manager and a deputy manager. They shall be appointed by the governor of the Reserve Association, with the approval of the executive committee.

The powers and duties of the manager and deputy manager and of the various committees of the branches shall be prescribed by the by-laws of the Reserve Association.

FUNCTIONS OF THE LOCAL ASSOCIATIONS

Any member of a local association may apply to that local association for a guaranty of the commercial paper which it desires to rediscount at the branch of the Reserve Association in its district. Any such bank receiving a guaranty from a local association shall pay a commission to the local association, to be fixed from time to time by the board of directors of that local association. The guaranty of the members of the local association, in the event of loss, shall be met by the members of the local association in the proportion to the ratio which their capital and surplus bears to the aggregate capital and surplus of the local association, and the commission received for such guaranty, after the payment of losses and expenses, shall be distributed among the several banks of the local association in the same proportion. A local association shall have authority to require additional security from any bank offering paper for guaranty, or may decline to grant the application.

The total amount of guaranties by a local association to the Reserve Association shall not at any time exceed the aggregate capital and surplus of banks forming the guaranteeing association.

FUNCTIONS OF THE RESERVE ASSOCIATION

All of the privileges and advantages of the Reserve Association shall be equitably extended to every national bank of any of the classes herein defined who shall subscribe to its proportion of the stock of the Reserve Association and shall otherwise conform to the requirements of this act.

The Government of the United States and those national banks owning stock in the Reserve Association shall be the sole depositors in the Reserve Association. All domestic transactions of the Reserve Association shall be confined to the Government and the subscribing banks, with the exception of the purchase or sale of Government or State securities or securities of foreign governments or of gold coin or bullion.

The Government of the United States shall deposit its cash balance with the Reserve Association and thereafter all receipts of the Government shall be deposited with the Reserve Association or (when necessary) with such national banks as the Government may designate for that purpose in cities where there is no branch of the Reserve Association. All disbursements by the Government shall be made through the Reserve Association.

The Reserve Association shall pay no interest on deposits.

The Reserve Association may rediscount notes and bills of exchange arising out of commercial transactions, for and with the indorsement of any bank having a deposit with it. Such notes and bills must have a maturity of not more than 28 days, and must have been made at least 30 days prior to the date of rediscount. The amount so rediscounted shall in no case exceed the capital of the bank applying for the rediscount. The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, corporation, or firm, rediscounted for any one bank, shall at no time exceed 10 per cent of the capital and surplus of said bank.

The Reserve Association may also rediscount for any depositing bank notes and bills of exchange, arising out of commercial transactions, having more than 28 days, but not exceeding four months, to run, but in such cases the paper must be guaranteed by the local association of which the bank asking for the rediscount is a member.

Whenever, in the opinion of the governor of the Reserve Association, the public interests so require, such opinion to be concurred in by the executive committee of the Reserve Association and to have the definite approval of the Secretary of the Treasury, the Reserve Association may discount the direct obligation of a depositing bank, indorsed by its local association, provided that the indorsement of the local association shall be fully secured by the pledge and deposit with it of satisfactory securities, which shall be held by the local association for account of the Reserve Association; but in no such case shall the amount loaned by the Reserve Association exceed two-thirds of the actual value of the securities so pledged.

The rate of discount of the Reserve Association, which shall be uniform throughout the United States, shall be fixed from time to time by the executive committee and duly published.

The Reserve Association may, whenever its own condition and the general financial conditions warrant such investment, purchase to a limited amount from a depositing bank acceptances of banks or houses of unquestioned financial responsibility. Such acceptances must arise from commercial transactions and have a maturity not exceeding 90 days, and must be of a character generally known in the market as prime bills. Such acceptances shall also bear the indorsement of the depositing bank selling the same, which indorsement must be other than that of the acceptor.

The Reserve Association may invest in United States bonds and in short-term obligations—that is, obligations having not more than one year to run—of the United States, or of any State, or of certain foreign governments to be named in the act.

The Reserve Association shall have power at home and abroad to deal in gold coin or bullion, to grant loans thereon, and to contract for loans of gold coin or bullion, giving, when necessary, acceptable security for their repayment.

The Reserve Association shall have power to purchase from its depositors and to sell, with or without its indorsement, checks or bills of exchange payable in England, France or Germany, and in such other foreign countries as the board of the Reserve Association may decide. These bills of exchange must arise from commercial transactions and be of a maturity not exceeding 90 days, and shall bear the signatures of at least three responsible parties, of which the last one shall be that of a depositing bank.

The Reserve Association shall have power to open and maintain banking accounts in foreign countries and to establish agencies in foreign countries, for the purpose of purchasing and selling and collecting foreign bills of exchange, and it shall have authority to buy and sell, through such agencies, prime foreign bills of exchange arising from commercial transactions, running for a period not exceeding 90 days, and bearing the signatures of two or more responsible parties.

DOMESTIC EXCHANGES

It shall be the duty of the Reserve Association or any of its branches, upon request, to transfer any part of the deposit balance of any national bank having an account with it to the credit of any other bank having an account with the Reserve Association. If a deposit balance is transferred from the books of one branch of the Reserve Association to the books of another branch, it may be done by mail or telegraph upon terms to be fixed from time to time by the executive committee.

FUNCTIONS OF NATIONAL BANKS

In addition to the rights now conferred by law, national banks shall be authorized to accept commercial paper drawn upon them, having not more than 90 days to run, properly secured, and arising out of commercial transactions. The amount of such acceptances shall not exceed one-half the capital and surplus of the accepting bank.

National banks shall not have authority to establish branches except in the city or town in which they are located.*

The organization of banks to conduct business in foreign countries shall be authorized. The stock of such banks may be held by national banks. The bank so organized may have an office in the United States, but shall not compete with national banks for domestic business not necessarily related to the business being done in foreign countries.

There shall be established a new class of national banks, to be known by a specifically designated name. Such banks may have savings departments and may make properly secured loans on real estate; such loans to be restricted to a certain proportion of the aggregate time and savings deposits in the bank. The reserve requirement in such banks will be less against savings and time deposits than against demand deposits.

Another class of national banks shall be authorized, which shall be in effect national trust companies, to be designated by some appropriate name and to exercise all the functions and have all the privileges, including length of charter, which are given to trust companies by the laws of the various States. These national institutions shall be subject, like other national banks, to inspection and examination by the National Government.

There shall be no change in the percentage of reserve required by law to be held against demand deposits by national banks, except as otherwise provided herein, but the deposit balance of any national bank in the Reserve Association shall be counted as a part of its legal reserve.

REPORTS TO THE COMPTROLLER

The Reserve Association shall make a report, showing the principal items of its balance sheet, to the Comptroller of the Currency once a week. These reports shall be made public. In addition, full reports shall be made to the Comptroller of the Currency coincident with the five reports called for each year from the national banks.

All reports of national-bank examiners in regard to the condition of national banks shall hereafter be made in duplicate, and one copy shall be filed with the Reserve Association for the confidential use of its executive officers.

National banks of all classes shall hereafter make a weekly report to the Comptroller of the Currency showing the principal items of their balance sheets, such reports to be available for the use of the executive officers of the Reserve Association.

NOTE ISSUES

There is hereafter to be no further issue, beyond the amount now outstanding, of bank notes by national banks. National banks may, if they choose, maintain their present note issue, but whenever a bank retires the whole or any part of its existing issue it will permanently surrender its right to reissue the notes so retired.

The Reserve Association must, for a period of one year, offer to purchase at——— (a price not less than par and accrued interest) the 2 per cent bonds now held by national banks and deposited to secure their circulating notes. The Reserve Association shall take over these bonds with the existing currency privilege attached and assume responsibility for the redemption (upon presentation) of outstanding notes secured thereby. The Reserve Association shall issue, on the terms herein provided, its own notes as fast as the outstanding notes secured by such bonds so held shall be presented for redemption, it being the policy of the United States to retire as rapidly as possible, consistent with the public interests, bond-secured circulation and to substitute therefor notes of the Reserve Association of a character and secured and redeemed in the manner provided for in this act.

The Reserve Association agrees to hold, for a period of not less than 10 years, the bonds so purchased, or any Government security which may be exchanged for them by

refunding or otherwise. The Reserve Association, however, shall have the right, with the approval of the Secretary of the Treasury, after two years to dispose annually of \$50,000,000 of the bonds held by it to secure circulation. The Government reserves the right at all times to purchase at par from the Reserve Association, through the trustees of the postal savings bank or otherwise, any or all of such bonds so held.

If the Government should adopt the policy of issuing securities at a higher rate of interest than 2 per cent, the Reserve Association shall have the right to exchange at par the Government bonds which it may have acquired from the national banks, previously held by them to secure circulation, for any bonds bearing interest at a rate not exceeding 3 per cent, but in that event the amount of annual taxes to be paid on notes based upon such new securities shall be as much greater as the interest rate of the new securities shall exceed 2 per cent.

To illustrate: If the Government should decide hereafter to issue a 2½ per cent bond, the rate of taxation on currency issued by the Reserve Association thereon would be 1 per cent, instead of one-half of 1 per cent, as on the existing twos, and upon a 3 per cent bond the rate of taxation would be 1½ per cent.

In addition to the authority to issue notes to replace any national-bank notes outstanding at the time of the organization of the Reserve Association, it shall have the right to issue additional circulating notes as follows: The whole or any part of the first \$100,000,000 of such additional notes shall pay to the Government an annual tax of 3 per cent; above \$100,000,000 and not more than \$200,000,000 may be issued at an annual tax of 4 per cent; above \$200,000,000 and not more than \$300,000,000 may be issued at an annual tax of 5 per cent; all above \$300,000,000 shall pay an annual tax of 6 per cent.

All note issues of the Reserve Association must be covered to the extent of at least one-third by gold or other lawful money, and the remaining portion by bonds of the United States or bankable commercial paper as herein defined, or both. (It should be provided either that the Reserve Association may also hold in its reserve foreign coin, or that the Treasury will issue gold certificates against foreign coin.) The notes are to constitute a first lien upon all the assets of the Reserve Association, and adequate provision must be made for their immediate redemption in lawful money on presentation at the head office of the Reserve Association or any of its branches.

The notes of the Reserve Association shall be received at par in payment of all taxes, excises, and other dues to the United States, and for all salaries and other debts and demands owing by the United States to individuals, corporations, or associations, except obligations of the Government which are by their terms specifically payable in gold, and for all debts due from or by one national bank to another, and for all obligations due to a national bank.

The Reserve Association shall at once, upon application and without charge for transportation, forward its circulating notes to any depositing bank against its credit balance.

D. Tables

**TABLE I.—DISTRIBUTION OF GOLD COIN AND BULLION IN
THE UNITED STATES, JUNE 30, 1912.***

Treasury (free)	\$233,470,647
Treasury (security for gold certificates)	930,367,929
National Banks	153,411,301
National Banks (security for clearing house certificates).....	79,758,000
Other Banks and in Circulation	356,126,237
Total	\$1,753,134,114

* Director of the Mint.

**TABLE II.—DEBT OF THE UNITED STATES, AND BONDS ON
DEPOSIT, JUNE 30, 1912.**

Class	Bonded Debt	Bonds on Deposit to Secure Circulation	Bonds on Deposit to Secure Government Deposits
U. S. Consols of 1930 (2s)	\$646,250,150	600,248,300	12,646,700
U. S. Loan, 1908-1918 (3s)	198,792,660	19,344,620	3,733,300
U. S. Loan, 1925 (4s)	162,315,400	\$ 23,790,000	\$ 3,716,000
Panama Canal loan:			
Series of 1906 (2s)	54,631,980	52,397,840	1,546,500
Series of 1908 (2s)	30,000,000	28,712,980	712,000
Series of 1911 (3s)*	50,000,000		16,218,000
Philippine loans and railway bonds (4s)			4,678,000
Porto Rico loans (4s)			744,000
District of Columbia bonds (3.65s)			847,000
Territory of Hawaii bonds (various) ...			685,000
State, city, and railroad bonds (various)			2,783,000
U. S. Postal Savings bonds (2½s)*	459,280		
Total	\$1,142,449,470	\$724,493,740	\$48,309,500
United States Notes ("greenbacks") issued during the Civil War..			\$346,681,016

* U. S. Bonds not available for note circulation.

TABLE III.—WORLD'S PRODUCTION OF GOLD, CALENDAR YEAR, 1910.*

COUNTRIES	Ounces (fine)	Value
North America:		
United States	4,657,017	96,269,100
Canada	493,707	10,205,800
Mexico	1,205,051	24,910,600
Africa	8,474,809	175,189,900
Australasia	3,167,140	65,470,600
Europe:		
Austria-Hungary	105,101	2,172,600
France	67,754	1,400,600
Germany	3,042	62,900
Great Britain	1,041	21,500
Italy	1,430	29,600
Russia	1,721,163	35,579,600
South America:		
Argentina	8,372	173,100
Bolivia	22,429	463,600
Chile .....	.....	.....
Brazil	94,557	1,954,700
Colombia	163,022	3,370,000
Ecuador	12,054	249,200
Guiana:		
British	57,697	1,192,700
French	97,029	2,005,800
Peru	24,890	514,500
Venezuela	16,472	340,500
Central America	225,302	4,657,400
Asia:		
British India	518,502	10,718,400
China	176,960	3,658,100
East Indies:		
British	69,988	1,446,800
Total**	21,996,297	\$454,703,900

*Report of the Director of the Mint, 1911.

**Including countries with smaller production not shown in the table.

TABLE IV.—BANKING POWER OF THE UNITED STATES.*

	Number	Capital	Surplus and Other Profits	Deposits	Circulation	Total
June 14, 1912: National banks	7,372	\$1,033,570,675.00	\$ 950,827,514.65	\$ 5,825,461,163.36	\$708,690,593.00	\$ 8,518,549,946.01
June 7, 1911: National banks	28,551	\$1,019,633,152.25	\$913,500,902.77	\$5,526,446,797.99	\$681,740,513	\$8,141,321,366.01
State, etc., banks . . .	17,115	932,777,933.31	1,152,073,936.93	\$560,000,000.00	.....	12,513,135,424.06
Nonreporting banks	24,159	\$80,000,000.00	\$40,000,000.00	10,428,283,553.82	.. .. .	\$680,000,000.00
Total	28,551	\$2,032,411,085.56	\$2,105,574,839.70	\$16,514,730,351.81	\$681,740,513.00	\$21,334,456,790.07

* Comptroller of the Currency.

1 Includes United States deposits.

2 Includes brokers.

3 Estimated.

TABLE V.—CONDENSED STATEMENT OF RESOURCES AND LIABILITIES OF ALL REPORTING BANKS OF THE UNITED STATES ON JUNE 7, 1911.*

[Includes national, State, savings, private banks and loan and trust companies.]

Resources (in Millions of Dollars)

STATES	Population (Estimated by Government Actuary)	Number of Banks	Loans and Discounts and Overdrafts	Investments, Bonds, Securities, Etc.	Due from Banks and Bankers	Cash on Hand	All Other Resources	Total
New England States 1).....	6,660,000	1,079	\$ 1,627.2	\$ 915.3	\$ 215.5	\$ 90.3	\$ 85.2	\$ 2,633.7
Eastern States 2).....	21,665,000	2,844	4,947.2	2,395.3	976.7	761.2	620.1	10,009.4
Southern States 3).....	26,327,000	5,765	1,401.6	239.9	306.8	112.4	118.0	2,178.6
Middle Western States 4)....	26,182,000	8,167	3,487.2	816.3	843.4	412.3	218.5	5,758.2
Western States 5).....	7,660,000	4,899	676.4	111.7	205.0	70.6	49.8	1,113.4
Pacific States 6).....	5,559,000	1,604	895.5	265.2	230.8	98.2	83.9	1,573.6
United States.....	94,053,000	24,358	\$13,015.1	\$5,043.7	\$2,778.2	\$1,545.5	\$1,184.5	\$23,567.1

Liabilities (in Millions of Dollars)

STATES	Capital Stock	Surplus and Un-divided Profits	Individual Deposits	United States Deposits	Due to Banks and Bankers	All Other Liabilities
New England States	\$139.5	\$ 254.3	\$2,323.4	\$ 4.6	\$ 137.8	\$ 74.0
Eastern States	600.0	1,066.4	6,676.9	9.9	1,337.5	318.7
Southern States	334.9	193.0	1,283.3	8.6	150.6	208.2
Middle Western States ...	561.5	375.0	3,759.5	12.8	761.7	287.7
Western States	138.3	68.0	742.0	6.1	90.9	68.1
Pacific States	171.4	105.3	1,081.3	6.1	135.5	74.0
United States.....	\$1,945.6	\$2,062.0	\$15,866.4	\$48.1	\$2,614.0	\$1,030.9

* Comptroller of the Currency, Annual Report 1911.

1) Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut.

2) New York, New Jersey, Pennsylvania, Delaware, Maryland, District of Columbia.

3) Virginia, West Virginia, North and South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, Texas, Arkansas, Kentucky, Tennessee.

4) Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, Missouri.

5) North and South Dakota, Nebraska, Kansas, Montana, Wyoming, Colorado, New Mexico, Oklahoma.

6) Washington, Oregon, California, Idaho, Utah, Nevada, Arizona, Alaska.

TABLE VI.—RESERVE OF THE NATIONAL BANKS ON JUNE 14, 1912.*
(In Millions of Dollars)

Banks located in	Reserve Required Per Cent	Legal Reserve Held †			All Reserves Held ‡		
		Amount	Per Cent	Excess Reserve	Amount	Per Cent	Excess Reserve
Central reserve cities	25	\$451.9	26.19	\$20.5	\$451.9	26.19	\$ 20.5
Reserve cities	25	492.7	25.48	9.3	543.8	28.13	140.4
All reserve cities	25	944.7	25.82	29.9	995.8	27.21	81.0
Country bank cities .	15	508.5	16.53	51.8	762.7	22.50	254.2
Grand total	..	\$1,423.4	21.35	\$81.7	\$1,758.5	24.94	\$335.1

* Comptroller of the currency.

† Including: Specie, legal tenders, redemption fund, and deposits with reserve agents available for *legal* reserve.

‡ Including: All deposits with reserve agents—those available and those not available for *legal* reserve.

TABLE VII.—CLASSIFICATION OF NATIONAL BANKS,
SEPTEMBER 1, 1911.*

Capital	Number	Percent	Total Amount of Capital	Percent
\$25,000	1,966	26.93	\$49,105,222	4.79
Over \$25,000 and less than \$50,000....	372	5.09	12,591,827	1.23
\$50,000 and less than \$100,000.....	2,297	31.46	122,973,320	11.98
\$100,000 and less than \$250,000.....	1,994	27.31	251,598,385	24.54
\$250,000 and less than \$1,000,000	495	6.78	197,016,930	19.22
\$1,000,000 and less than \$5,000,000 ...	161	2.21	232,155,700	22.64
\$5,000,000 and over	16	.22	160,000,000	15.60
Total.....	7,301	100.00	\$1,025,441,384	100.00

* Comptroller of the Currency, Annual Report 1911.

TABLE VIII.—GOLD IN THE TREASURY AND IN THE BANKS
OF THE UNITED STATES.*

(In Millions of Dollars)

	U. S. Treasury June 1, 1912	National Banks June 14, 1912	State Banks June 7, 1911	All Banks	Total
Gold coin and bullion ..	165.9	149.2	79.4	228.6	394.5
Gold certificates	97.3	356.6	189.2	545.8	643.1
Clearinghouse certificates	—	80.4	—	80.4	80.4
	263.2	586.2	268.6	854.8	1,118.0

* Comptroller of the Currency.

TABLE IX.—GOLD AND SILVER IN THE EUROPEAN CENTRAL
BANKS, JUNE 6, 1912.

	Gold	Silver	Total
England	\$197,324,452	.....	\$197,324,452
France	628,959,640	\$158,532,338	787,491,978
Germany	218,757,553	86,330,000	305,087,553
Russia	728,896,800	38,479,900	767,376,700
Austria-Hungary	255,585,300	61,085,750	316,671,050
Spain	82,605,200	147,163,550	229,768,750
Italy	205,252,000	17,702,500	222,954,500
Netherlands	58,733,500	4,866,490	63,599,990
Belgium	31,984,134	15,992,065	47,976,199
Sweden	23,246,050	.....	23,246,050
Switzerland	31,040,000	.....	31,040,000
Norway	10,340,200	.....	10,340,200
Total	\$2,472,724,828	\$530,152,593	\$3,002,877,422

INDEX

Index

Acceptances:

(See Bank Acceptances.)

Customer's bills, 32.

Agriculture:

Secretary of, 71, 72.

Real estate loans, 53, 103.

Staple products and credit facilities, 22, 103, 114, 171-172.

Representation in the N. R. A. and Branches, 70, 71, 72.

Andrew, A. Piatt, formerly Assistant Secretary of the Treasury, xiii, 25, 91, 124.

Aldrich, Nelson W., formerly U. S. Senator from Rhode Island, Chairman of the National Monetary Commission, 100, 125.

Aldrich Plan:

Original edition, 195-203.

Revised edition, 204-210.

Aim of the, 114, 119, 155.

Aldrich-Vreeland Act: 27.

Anderson, Frank B., President of the Bank of California, San Francisco, 102, 125.

Bank of England:

Note circulation, 118, 154, 155.

Preferential position in Europe, 155.

In crises, 155.

Bank of France:

Note circulation, 48-49, 117, 156.

Discount business, 126-127.

Weekly reports, 48-49.

During the war of 1870-71, 173.

Bank of Germany:

(See German Reichsbank.)

Bankers:

Acceptances of, 102.

Transactions of, with the N. R. A., 135.

International money market and, 134-135.

Banking Law Journal, The: 69.

Banks:

(See National Banks

State Banks and Trust Companies.)

American, for foreign countries, 56, 106-109, 143.

Bank Acceptances:

Usefulness of, in trade and industry, 33.
Settlement of international obligations by, 19, 33, 102.

Money market and, 18, 34.

By national banks, 19, 56, 100-102, 139, 142-146, 147.

Private bankers, 102.

Overexpansion of credit through, 145-146.

Discount of, at the N. R. A., 94, 95, 131.

Bank Examination:

Of national banks, 8.

Of the N. R. A., 75.

Of member banks, 104.

Bank Failures:

Note circulation in case of national, 6.
In crises, 23.

Bank Notes:

Functions, 10-12.

Secured by government bonds, 5, 10, 12-13, 24, 51, 154-156.

Of national banks, 5, 10, 12, 24, 49.

Retirement of national, 6, 12.

Redemption of national, 5, 79.

Profit of national banks from, 6, 13.

Elastic circulation, 10-12, 29, 39, 116.

Relations of, to the changes of business, 10-12, 29, 44-47, 116.

Of European central banks:

Bank of England, 118, 154, 155.

Bank of France, 48-49, 117, 118.

German Reichsbank, 43-48, 118.

Cash reserve for, 45, 79, 82, 83, 84-87, 99, 117.

- Commercial paper as security for, 29, 79, 82, 83, 87, 116, 154.
 Tax on circulation, 6, 82.
 Of the national banks replaced by notes of the N. R. A., 56, 78-82, 115-120, 137-138.
 As reserve for member banks, 88, 105.
 Government debts as security for, of the N. R. A., 79, 87-88.
 Redemption of, by the N. R. A., 88.
 Overexpansion of credit through the N. R. A., 82, 116.
 Denomination, 118-119.
 Gold reserve, 77, 83.
 "Uncovered" notes, 44-45, 47, 83, 117.
 Legal tender, 88.
- Bank Shares:**
 Of the N. R. A., 62, 64, 65, 69, 70, 73, 76, 98.
 Of American banks for foreign countries, 107, 109, 139, 143, 149.
- Bills of Exchange:**
 (See Bank Acceptances.)
 In the U. S., 17-22, 51-52, 142.
 Promissory notes, 19, 142.
 Use of, in domestic business, 32-33.
 Standardization of, by bank acceptances, 18, 33, 142-146.
 Prime bills in Europe, 34.
 "Private discount," 34, 125.
 Rates of discount, 33.
 "Private" rate of discount, 34, 125, 142.
 As investment for "surplus funds," 18, 20-21, 32, 34, 35.
 Note circulation and, 29-30, 44-47.
 Money market and, 18, 31-36.
 Business of the N. R. A. in domestic, 92-97, 130-133, 150.
Limitation on discount business of the N. R. A., 92, 93, 95-97, 122-136.
 Rediscount of, for member banks by the N. R. A.:
 Bills without guaranty of the local association, 94-95.
 Bills guaranteed by the local association, 95-97, 130-131.
 Discount of, for non-members, 150.
 Rediscount of, in the open money market by the N. R. A., 123, 125, 150.
 Prime bills and the N. R. A., 93, 94, 132, 150.
 Preferential rate on prime bills, 132, 150.
 Business of the N. R. A. in foreign bills, 90, 93, 95, 134-136.
 Foreign bills and gold policy, 37, 51, 90, 133, 136.
- Board of Directors:**
 (See Directors of the N. R. A., Branches of the N. R. A., Local Associations.)
- Board of Examination:** 75.
 (See Bank Examination.)
- Bonds:**
 (See Government Bonds.)
 Other than government bonds used in emergency, 24, 27, 79.
- Branches of the N. R. A.:**
 Location, 67-68, 76.
 Organization, 70-71.
 Management, 71.
 Functions, 72, 73, 92, 93, 136.
 Participation in the election of directors of the N. R. A., 72, 73.
- Call Loans:**
 (See Surplus Funds.)
 Wall Street and, 21-22, 153-154.
 Speculation and, 21-22.
 Investment for "surplus funds," 17, 18, 20, 52, 154.
- Capital Stock:**
 Of national banks, 4, 121.
 Of the N. R. A., 62-67, 76, 115.
 Of member banks, 105-106, 121.
 Of American banks for foreign countries, 108, 109.
- Central Banks:**
 (See Centralization.)
 Money market and, 18, 35, 39-40, 125.
 General policy, 35-37.
 Gold policy, 37, 133.
 Discount policy, 37-41, 122, 127, 128, 129.
 Operations of, and seasonal demand, 29-31, 44-47.
 Crises and, 27, 30, 38, 122, 155-156.
 Panics and, 24, 27, 30, 31, 38.
 Difficulty in the management of a central bank, 157, 160, 161, 165.
 Government influence on, 54, 72.
 N. R. A. not a central bank, 55, 77, 113.
 In Europe, 28-49, 124-127.
- Centralization:**
 (See Central Banks.)
 Of the note issue:
 In the U. S., 54, 77, 78-82, 114, 147, 159.
 In Europe, 28, 30.

Political objections to, 54, 113, 129, 152.

Of the cash reserves:

 In the U. S., 50, 57, 91-92, 114, 140, 159.

 In Europe, 28, 30-31, 140.

Domination of special interests, 54, 55, 157.

Advantages and disadvantages, 30, 31, 54, 141.

Central Reserve Cities:

 (See Reserve Cities.)

Certificates:

 (See Clearing House.)

Charter of the N. R. A.: 61.

Clearing House:

 In the crisis of 1907, 25-27.

 Certificates of the, as emergency currency, 25, 51.

Commercial Paper:

 (See Bills of Exchange, Bank Notes.)

Comptroller of the Currency:

 National banks and the, 7, 8.

 Member of the board of directors of the N. R. A., 71, 75, 98.

 Member of the organization committee, 76.

 American banks for foreign countries and the, 107, 108, 109.

 Currency Associations and the, 158, 164, 166.

Control:

 Of national banks, 8.

 Of the N. R. A., 98.

 Of member banks, 104.

 Of American banks for foreign countries, 107, 108, 109, 143.

Country Banks:

 Capital and resources, 4.

 Reserves, 16.

 Crisis and, 14, 23.

Credit:

 (See Bank Acceptances, Bank Notes, Bills of Exchange, Overexpansion.)

Currency:

 (See Bank Notes.)

Currency Associations:

 (See Aldrich-Vreeland Act.)

 Banking reform through, 158.

Demand Deposits:

 (See Deposits.)

Denomination:

 (See Bank Notes.)

Deposits:

 Under the present legislation:

 In national banks, 6-9, 14-17.

 In state banks and trust companies, 8-9.

 Cash reserve for deposits in national banks, 7, 15, 16.

 Under the proposed plan:

 Interest on deposits in N. R. A., 91.

 Reserves in the N. R. A., 84-87, 99, 117.

 * "Giro" deposits, 92, 137

 Reserves in the member banks, 88, 92, 105-106, 139.

 Time deposits and loans on real estate, 102-104.

Direct Obligation:

 Of a bank discounted by the N. R. A., 95, 131.

Directors of the N. R. A.: 71-76, 77, 153, 157, 166, 167, 175.

Discount Market:

 (See Bills of Exchange.)

 Centralized banking a prerequisite for a, 18, 35, 141.

 Essential for the development of a money market, 17.

 Credit facilities for the business community, 31-34, 142-143.

 Standardization based on "private discount," 34, 142.

 In the U. S., 17-22, 51, 52, 56, 114, 142.

 In Europe, 31-49, 125-127.

Discount Policy:

 (See Central Banks, Money Market.)

 Of a central bank, 37-41, 122.

 Protection of the gold reserve by, 37, 133.

 A means to check overexpansion, 37-38, 122, 129, 149.

 Hampering restrictions in the plan, 122-137, 146, 148, 170, 174.

Discount Business of the N. R. A.:

 (See Bills of Exchange, Discount Policy, Money Market.)

 Domestic bills, 92-97, 130-133, 150.

- Exclusion of non-members, 93, 122-136, 148.
- Unnecessary requirement for guaranty by local associations, 130.
- Direct obligation of a bank, 95, 131.
- Prime bills, 93, 94, 132-133, 149, 150.
- Foreign bills of exchange, 93, 95, 134-136, 149.
- Discount Rate:**
(See Rate of Discount.)
- Districts:** 68, 73, 76.
- Domestic Exchange:**
In the U. S., 51, 92, 136-137.
In Germany, 45, 46, 137.
- Drafts:**
(See Bills of Exchange.)
On customers, 32.
On banks, 33.
- Earnings of the N. R. A.:** 66.
- Emergency Currency:**
(See Aldrich-Vreeland Act.)
Emitted by central banks, 26.
Clearing House certificates in 1907, 25-27.
Currency associations, 27.
- Europe:**
Conditions in banking and industry compared with the U. S., 28, 31, 127-128, 157-158, 161-163.
Political opposition to central banking, 158, 163.
European efforts to dominate American trade, 157, 159.
- Everybody's Magazine, New York:** 23, 175.
- Executive Committee of the N. R. A.:** 71, 74, 95.
- Export:**
(See Foreign Trade.)
- Failures:**
(See Bank Failures.)
- Farmers:**
(See Agriculture.)
- Foreign Bills of Exchange:**
(See Bills of Exchange,
Discount Business of the N. R. A.)
- Foreign Trade:**
Bank acceptances, 19, 33.
Financing of America's, by European banks, 19-20, 52, 102, 172.
- Improved conditions for financing under the plan, 56-57, 101-102, 107, 142-143, 171-172.
- Forgan, James B.,** President of the First National Bank of Chicago, Chicago, Ill., 15, 91, 169.
- Franchise Tax:**
On national bank notes, 6, 87.
On bonds held by the N. R. A., 81-82.
On earnings of the N. R. A., 66.
- German Reichsbank:**
Tax on note circulation, 83.
Relation to the government, 47, 72.
Publicity, weekly reports, 41-48.
Elasticity of note circulation, 44-47.
Cash reserve for notes, 45, 47, 83, 118.
Discount business with bankers and direct relations to the business community, 126-127, 128, 129.
Influence on the money market, 40.
Rediscount of treasury bills, 40.
Operations in crises, 24.
"Giro" business, 45, 46, 92, 137.
- Germany:**
(See Europe,
German Reichsbank.)
- Giro Business:**
(See Domestic Exchange,
German Reichsbank.)
- Gold:**
Security for note circulation, 37, 83.
Gold policy, 37, 133.
Gold policy of the N. R. A., 77, 89-91, 134, 136.
Gold standard and the notes of the N. R. A., 83.
- Government:**
(See Franchise Tax,
Government Bonds.)
Influence of, on central banks, 54.
Influence of the, on the N. R. A., 61, 71-72, 75, 120, 153, 175.
Deposits of the, with the N. R. A., 57, 91, 171.
Independent Treasury, 53, 91.
- Government Bonds:**
Basis for note circulation of national banks, 5, 65, 78-79.
Relation of, to note circulation of the N. R. A., 65, 78-82, 87-88, 99, 115, 138.
Conversion of 2%, into 3%, 80, 88, 89.
Redemption of the 3%, 80, 88.
Business of the N. R. A. in, 89, 90.

Government Deposits:

(See Government.)

Governors of the N. R. A.: 75-76, 95, 152.

Import:

(See Foreign Trade.)

Inflation:

(See Overexpansion.)

Inspection of Banks:

(See Bank Examination, Control.)

Interest:

(See Rate of Interest, Rate of Discount.)

"Interests, The":

Influence on central banks, 54.

Influence on the N. R. A., 64, 69, 70, 71, 72-74, 120, 153, 157, 159, 166, 175.

Control of decentralized banks, 165, 166.

Lacy, Graham G., President of the Tootle-Lemon National Bank, St. Joseph, Mo., 168.

Legal Tender:

Notes of the N. R. A., 88.

Loans:

(See Call Loans.)

On commercial paper, 34.

On real estate, 53, 102-104.

In current account, 34.

Local Associations:

Organization, 68-70, 76.

Participation in the election of directors of the branches of the N. R. A., 70.

Guaranty of commercial paper, 96-97, 130.

Guaranty of direct obligations of member banks, 95-96, 181.

Membership in the N. R. A.:

Requirements, 62, 63, 104-106, 121, 130, 149.

Privileges, 66, 77, 92, 99-104, 139, 149, 150, 151.

Merchants:

Credit facilities in the U. S., 18, 21, 52, 101-102, 114.

Credit facilities in a developed money market, 21, 31-34, 142-144, 171.

Direct relations to central banks, 32, 125-127, 135, 150.

Monetary Commission:

(See National Monetary Commission.)

Money Market: 34.

(See Bankers,

Bank Acceptances,

Bills of Exchange,

Central Banks,

Discount Market,

German Reichsbank,

Merchants,

Overexpansion,

Rediscounts.)

Monopoly of Note Issue:

(See Centralization.)

Morawetz, Victor: 132, 153, 155-157.

Muhlemann, Maurice L.: 69.

National Banks:

Under present conditions: 3-9.

Note privilege, 5-6, 12-13, 49, 138.

Deposits, 6-9.

Reserves, 7, 14-17.

Compared with state banks and trust companies, 9, 100, 139.

Under the proposed legislation:

Abandonment of the note privilege,

65, 78-82, 137-138.

Reserves, 88, 92, 105, 139.

Acceptances, 56, 100-102, 139, 142-146, 147, 149.

Real estate, 102-104, 139, 140, 147, 149.

National Currency Associations:

(See Aldrich-Vreeland Act.)

As substitute for centralization, 158, 164.

National Monetary Commission:

Report, 50, 53, 74, 81, 83, 102, 147.

Defects of the present banking system stated in the report, 50-53.

Bill, 179-194.

New York Evening Post, The: 168.

Non-Members of the N. R. A.:

Exclusion of, from business with the N. R. A., 77, 89, 90, 93.

Admission of, to business with the N. R. A., 150.

Notes:

(See Bank Notes,

Bills of Exchange.)

Overexpansion of Credit:

Through a central bank, 149, 157, 160, 165.

Avoidance of, by using commercial paper as bank note security, 30.
 Effect of inefficient centralized banking, 123-125, 160.
 Through an independent money market, 148.
 Through bank acceptances, 145-146.
 Safeguards in the plan against note inflation, 82, 116, 149, 160.

Organization Committee: 68, 77-78.

Panics:

Causes, 13, 14, 15, 23, 31.
 Decentralized banking and, 14, 15, 23-27, 160-161, 164, 165.
 Events in 1907, 22-27.
 Centralized banking, 24, 30-31, 38, 114, 122, 129, 155, 161.
 Prevention, 24, 30-31, 38, 113, 114, 122, 129, 155, 161.

Patron, Maurice: 127.

Political Opposition:

To the Aldrich plan, 54, 113, 129, 152.
 To central banking in Europe, 158, 163.

Publicity:

Value, 42-43, 48.
 Provision under the present system, 8, 49.
 In Europe, 41-49.
 Provisions for the N. R. A., 98.
 Provisions for member banks, 104.
 Provisions for American banks for foreign countries, 108.

Rate of Discount:

Indicates policy of central bank, 40-41.
 "Official" rate, 33, 34, 125.
 "Private" rate, 34, 125, 142.
 Uniform, in the U. S., 93, 132-133, 148.
 Preferential, for member banks, 150.
 Preferential, on prime bills, 33, 34, 132-133, 150.

Rate of Interest:

On deposits in the N. R. A., 91.

Real Estate:

Loans on, by national banks, 53.
 Loans on, by state banks and trust companies, 8, 139.
 Held by the N. R. A., 97-98.
 Loans on, under the plan, 102-104, 139, 140, 147.

Redemption of Notes:

(See Bank Notes.)

Rediscounts:

Money market and, 34, 39, 40.
 Central banks, 18, 125, 129.
 Policy of central banks in the open money market, 39-40, 125.
 Position of the N. R. A., 123, 125, 150.
 Limitation on, for member banks, 95-97, 130-131.
 Guaranty of, by local associations, 96-97, 130-131.

Reports:

(See Publicity.)

Reserve Cities and Central Reserve Cities:

Under the National Bank Act:
 Reserves in, 7, 16.
 Failure of system, 10, 14, 23-25.
 Under the proposed legislation, 105, 125.

Reserves:

(See Bank Notes,
 Deposits,
 Surplus Funds.)

Under the National Bank Act:

For note circulation, 5.
 For deposits, 7, 14-17.

Under the proposed legislation:

For note circulation of the N. R. A., 45, 79, 82-87, 99, 117.
 For deposits of the N. R. A., 84-87, 99, 117.
 For deposits in member banks, 105-106, 139.
 Of European note banks, 29, 117, 118.
 Of European commercial banks, 28, 140.
 Suspension of payment caused by dis-
 persion of, 23-25, 50.
 Centralization of, 28, 30-31, 50, 57, 91-92, 140.

Restrictions:

(See Bank Notes,
 Membership.)

Of the Association to dealings with mem-
 ber banks only, 77, 89, 90, 93, 120-137.
 On rediscount facilities, 95-97.
 Danger of overexpansion from limitation
 of dealings, 123.

Roberts, George E., Director of the Mint:
 23, 175.

Secretary of Agriculture:

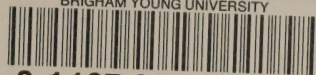
Member of the board of directors of the
 N. R. A., 71.
 Member of the organization committee,
 76.

Secretary of Commerce and Labor:

Member of the board of directors of the

N. R. A., 71.
 Member of the organization committee, 76.
Secretary of State: 77, 108, 109.
Secretary of the Treasury:
 (See Treasury.)
 Member of the board of directors of the N. R. A., 71, 75, 77, 95.
 Member of the organization committee, 76.
Shares:
 (See Bank Shares.)
Speculation:
 Policy of central banks, 37-38.
 Check on, through discount policy, 38.
 Call loans and, 21-22, 52.
State Banks and Trust Companies:
 Under present conditions, 8, 9.
 The N. R. A. and:
 Minimum capital, 100, 105-106, 121, 139.
 Examination by the N. R. A., 104.
 Reserves, 88, 92, 105-106.
Statements:
 (See Publicity.)
Stock Market:
 (See Call Loans.)
Strong, Jr., Benjamin, Vice President Bankers' Trust Company, New York City, 121.
Surplus:
 Of the N. R. A., 66.
 Of trust companies, 105.

Surplus Funds:
 Definition, 18.
 Investment of, under the present American system, 20-22, 153-154.
 Call loans, speculation and, 21-22, 52, 154.
 Commercial paper and investment of, 18, 21, 32, 34, 35.
Taft, William H., President of the United States, 113, 174.
Talbert, Joseph T.: 118.
Taxes:
 On the N. R. A.:
 On note circulation, 32.
 On deficiency in the reserves, 82, 84, 99, 117.
 On holdings of bonds, 81-82.
 On earnings, 66.
 On real estate, 67.
 Exemption from state and local, 67.
 On national banks, 6, 81.
Time Deposits:
 (See Deposits.)
Treasury of the United States:
 Disadvantages of independent, 53, 91.
 The national banks and, 5, 6.
 The N. R. A. and, 57, 91, 171.
Trust Companies:
 (See State Banks and Trust Companies.)
Vreeland:
 (See Aldrich-Vreeland Act.)
Warburg, Paul M., of Kuhn, Loeb & Co., New York City: 143, 163.
Wood, Edward R., A.M., LL.B.: 128, 156-167.



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